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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

INQUIRY INTO THE SUPERANNUATION INDUSTRY

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

TRANSCRIPT OF PROCEEDINGS

AT SYDNEY ON THURSDAY, 10 MAY 2001, AT 9 AM

MR COSGROVE: Good morning everyone. I would like to welcome you to the commencement of the Productivity Commission's review of the Superannuation Industry Supervision Act 1993 which I think we'll refer to hereafter as the SISA, as it's commonly known, and certain other superannuation legislation. My name is John Cosgrove. I am the presiding commissioner on this inquiry and beside me is Roger Freney who is an associate commissioner for the duration of the inquiry. I think it might be worthwhile if I make some opening remarks which I hope will assist participants' involvement in the inquiry and at least for the uninitiated explain the way in which these hearings are conducted.

This is a national competition policy review of the legislation in question and accordingly the review must have regard to the Commonwealth government's analytical requirements for regulation assessment including those set out in the competition principles' agreement reached between the Commonwealth, states and territories in 1995. In essence that means that legislation which restricts competition or imposes costs or confers benefits on business should be retained only if two conditions are met. The first is that the benefits to the community as a whole outweigh the cost. The second is that the objectives of the legislation cannot be achieved more efficiently through other means including non-legislative approaches.

It's important that this approach to the review is understood. The terms of reference for the review preclude the commission from considering certain matters. These include taxation matters affecting the superannuation industry, provisions of the SIS Act that have recently been subjected to regulation review or to a regulation impact statement, such as the provisions dealing with the supervision of self managed funds, rules relating to in-house investments and provisions covered by the financial services reform bill. Interesting and important though these excluded matters are, this review clearly has a narrower focus. In addition to the relevant parts of the SIS Act itself the legislation covered by the terms of reference are as follows: the Superannuation Self Managed Superannuation Funds' Taxation Act 1987, the Superannuation Self Managed Superannuation Funds' Supervisory Levy Imposition Act 1991, the Superannuation, Resolution of Complaints Act 1993, The Occupational Superannuation Standards Regulations Applications Act 1992 and the Superannuation Financial Assistance Funding Levy Act 1993.

That is quite a smorgasbord of legislation and we would welcome information and opinions from participants who have experience with any of those acts. The purpose of these hearings is to give interested parties the opportunity to put their submissions and views on the public record. This will help the commission in its task of assessing the costs and benefits of the legislation and reviewing possible alternative means of achieving the objectives of the various acts. We intend to conduct the hearings as informally as possible. Participants are required however to present accurate information and to refrain from misleading the commission.

A transcript of the hearings is made to provide a public record of the discussions and to allow those unable to attend the hearings to be informed of the discussions. Transcripts and non-confidential submissions to the inquiry are public documents.

They can be viewed at the commission's offices in Canberra and Melbourne. They can be viewed also at public libraries in capital cities and obtained from the commission's Web site. Copies of these documents can also be purchased. Order forms are available from our staff here today or can be obtained by contacting the commission later. After this initial hearing in Sydney there will be a hearing in Melbourne on 15 and 16 May. We intend to release a draft report for public consideration in July. A further round of public hearings will then be held after people have had time to examine that report. Reactions to the draft report will of course be taken into account in the preparation of the commission's final report which is due to be delivered to the government in early November.

Copies of the draft report will be provided to all those who have made submissions to us as well as those who appear at hearings or register an interest in the inquiry. While initial submissions will be accepted by the commission after these preliminary hearings, the sooner they are provided the more likely they are to be given full consideration in the preparation of the draft report. We have a list of participants who intend to appear today. If any others who have not yet informed the commission that they wish to appear I would ask them to register their interest with the staff during the course of the day.

It is not possible for us to take comment from the floor during the hearings. I will be asking participants to identify themselves and the capacity in which they're appearing before us today. I think we can without any further ado call our first participant which is the Association of Superannuation Funds of Australia. Yes, come up to the microphones. Would you please identify each other and indicate the capacity in which you're with us today.

MS ANDERSON: I am Michaela Anderson and I appear on behalf of the Association of Superannuation Funds of Australia where I am the director of policy and research.

MR HODGE: I am Robert Hodge. I also appear on behalf of the Association of Superannuation Funds of Australia where I am a senior policy adviser.

MR COSGROVE: Thank you. Michaela, we've received your submission. Thank you very much for it. There are some issues which we would like to discuss with you. Were there any key points about it that you wanted to make at the outset or not?

MS ANDERSON: If it's possible I would like to just talk to the summary of our submissions to make some points there. We support the current framework of a regulation of the superannuation industry which is centred on trustees and mandates a single responsible entity. I think this last point is very important. A major objective of the Managed Investments Act which is mentioned in the document that we've been addressing was introduced to establish a regime in which there was a single responsible entity for managed investments. Now, superannuation already has this essential feature. The trustee is responsible. ASFA believes that the principle of trusteeship, namely a trustee designated to administer funds in the best interests of beneficiaries is suited to the superannuation industry with long-term objectives, a large number of often financially unsophisticated members and rights enjoyed by non-member beneficiaries.

The compulsory nature of superannuation reinforces the need to maintain a government's approach that's very strong but yet flexible. It is ASFA's view that the trustee structure has advantages over other management structures. There is a body of common law that exists around which a principle based regulatory regime can be structured. Where prescription is required or desired this can be achieved by legislating exceptions to the trustees' duty under trust law. The removal of the trustee structure would necessitate a much more inflexible proscriptive regulatory regime in our view. The other very important point we would like to make is that the removal of the trustee structure would, we believe, inhibit competition as smaller players would be barred and some of the current large players would be unable to participate.

For example, we think that industry funds and corporate funds would have great difficulty in some other structures that might be proposed. This is a point that's also made in the submission of the Institute of Chartered Accountants. Many corporate funds which perform very well for their members would be likely to close their funds if there was large-scale change. They would probably decide that it's not part of their core business: they've had enough of change and that's the end of that. That would mean a considerable lessening of competition within the sector. The industry funds forum in their submission argue strongly and cogently in support of the trustee structure. The industry fund forum members are also members of ASFA and on our board of management and it would be fair to say that the entry of industry funds into the superannuation system was one of the greatest advances in competition. To jeopardise their place in the market would be an immense step backwards.

We support the framework of legislation and agree with the points made in the Institute of Chartered Accountants' submission, that the complete package approach insists, and the circulars which seek to interpret it, is of great benefit. This package approach is, we believe, disintegrating and if the rules for superannuation funds continue to be placed in a variety of statutes then complexity, cost and non-compliance is likely to increase. Some of the statutes we're talking about are beyond your terms of reference but we would like to draw attention very much to the trend of disintegrating package.

The implementation by the regulators though is of some concern in some areas. The primary areas of concern which may increase costs and inhibit competition are a lack of coordination in the regulatory activity of the regulators and this is of course another fragmentation issue, and associated with that differing requirements from regulators where there may in fact be similar responsibilities under the act. Despite the strong support for the conceptual basis upon which the superannuation legislation is premised, ASFA is concerned about a creeping prescription and a complexity within the SIS regime and its potential to increase costs and inhibit competition both between superannuation funds and between service providers of superannuation funds. We talk a little bit more in depth in our submission about this.

Just to raise a couple of areas there: one of them is for example what we call the over sixties problem where the rules for making contributions to a fund and for paying benefits seem to be out of step with society's practice as much as anything else and indeed with what we would think both industry and government would like to see going forward when we have an aging population which we would hope to keep in the workforce for longer and certainly those rules cause difficulty for funds. They increase costs but they also seem to have bad public policy associated with them. If anything the regulator's attempt in one instance to tighten the rules made the problem worse. The other area which we would point to is where we have non-resident workers and this is a point made by the Institute of Chartered Accountants and we agree with them, that where you have a global workforce some of our legislation doesn't cope with that. Some of that is tax but some of it is also involved with preservation which is part of the SIS regime.

I think that's an area that really needs to be looked at quite closely. We support the requirement that certain tasks be undertaken by qualified members of professional bodies. SIS recognises the existence of professional standards and we think that's a good way to go. Where there's a breach of professional standards the regulator retains the capacity to ban the professional from performing compliance tasks on funds and we think that's a good safeguard. We think that the benefits of the use of professionals is argued particularly well, probably better than we have, by the Institute of Actuaries of Australia in their submission. We would point you in that direction for very good argument.

We do not believe though that in some areas there is a need for further regulation. In some areas, for example in administration of funds where the trustee is in charge and where you in fact probably need - administration is very varied. What people want from an administrator is quite varied so it would be quite difficult to tighten the rules in any way except to make very certain that the trustee has a good contract and that's the way to go there. We believe that better disclosure on how the regulator intends to apply the penalty provisions is essential for the industry particularly where the use of enforceable undertakings and strict liability provisions are involved. It's a matter of how you will implement rather than the penalties themselves.

We strongly support the continued role of the statutory complaints body, the Superannuation Complaints Tribunal. We regard this as an essential element to maintain public confidence in compulsory contributions; a key element in the government's retirement income strategy and our submission to the High Court when the Superannuation Complaints Tribunal was in some difficulties is probably the best that we could put to you to outline our position and we have summarised some of our arguments in our full submission. Thank you.

MR COSGROVE: I think there is a good deal of interesting material in the submission which we might work through section by section, Michaela. Let me begin by asking you a question related to I think one of your major points and that is the value of the trustee structure and the package approach relative to something like a managed investment scheme structure. As you have said, for various reasons the complexity of the legislation seems to be growing over time and perhaps partly as a function of that we have seen a big decline in the number of employer sponsored funds in existence, although I would think it's the case that the industry funds are probably still growing in number and in the volume of assets under their control.

The SIS Act is complex and in many ways prescriptive, whereas a managed investment act type of approach seems to give somewhat more flexible arrangements to the people who are subject to it in terms of how investments are to be handled.
Do you feel though that notwithstanding - in fact perhaps because of it - because of that flexibility that the SIS Act is still somehow better suited to the nature of superannuation, notwithstanding the fact that its implications for the number of funds might not be as great as they have been, given as I said the number of corporate funds which are in decline and also the seemingly inexorable growth in complexity of SIS itself?

MS ANDERSON: I think we have to remember that there are still 2000 corporate funds and I mean I think they would not be there if you were under a managed investment regime. I can't see how they would fit in under that. I think there has been some consolidation, there has been some changes there. I think the demise of them so far has been somewhat exaggerated, particularly in the media. There has been quite a lot of consolidation amongst them. Where for example you might have had a number of funds with a company, you now may only have one. A lot of the numbers falling are also because of amalgamations of companies and therefore of their superannuation funds.

So to find the real trend of whether employers are giving up at the moment is really difficult. A lot of the consultants who work out there say they are not, that that isn't the real trend. What the trend is to amalgamate some of the funds that they have themselves, that's a real trend. To move from defined benefit to defined contribution is certainly a trend and that often goes with this amalgamation. But when we have tried to see whether everybody is going over to a master trust, well, some are, but a lot aren't and a lot who would come to the table, employers who have come to the table to decide what to do have decided to stay with their fund. So the problem is then if you move to a different regime it would probably cause them to move out.

Certainly the whole question of net tangible assets of having to have - it would make it very difficult for the company to sort of work on other than a trust basis. It would make it very difficult for industry funds as well. I can't see how you could have the involvement of those so-called in the jargon "new mutuals" if you like, coming in and making such an impact on the system. The impact I would have to say has been in a lot of areas, certainly in terms of cost. The industry funds have been, if you like, the spark that has tried to bring down administration costs and if you look at the retail sector you will find a lot of retail funds that have then followed that and have sort of look-alikes which have similar low costs. So in that area I think we can demonstrate that they have been a force of good in bringing down costs. With a different structure, I'm not sure that we could have allowed that sort of competition to come in, or if we change it now, to remain.

MR COSGROVE: I have seen some statistics, I've forgotten in what submission they are, that there has been a decline of something like two-thirds in the number of employer sponsored funds I think roughly in the last five years of the previous decade. Would you caution us against over-interpretation of that decline for the reason that you mentioned that there was now some degree of consolidation of funds with a single employer?

MS ANDERSON: I think you would have to have a look behind that and I'm not saying that some employers aren't saying, "I've had enough, this is not my core business, let's go to a master trust", but it is not a sort of lemming response that everyone is doing that. There is a sort of questioning of, "Do we stay here, do we consolidate our own funds, what do we do?" which is a good point. I think my point is we would not like to sort of push a whole sector out.

MR COSGROVE: Apart from the points you have mentioned about the possible demise of such funds and perhaps the industry funds as well, would you be worried on any other scores about the possible move to a managed investment scheme approach?

MS ANDERSON: I think we would lose the representative structure, the trustee structure which is equal representation I think has a lot of merit. I think the notions behind a trust structure we really shouldn't lose sight of where the interests are the beneficiaries. That's I suppose the other reason why those corporates and industry funds are a good part of the competition if you like, in that they are not beholden to shareholders, so that structure actually gives another edge there in the competition. So if we are talking competition here, I think we have to be careful of how we move, or we will destroy it.

MR COSGROVE: Thanks very much, Michaela, that was a perfect point for me to pick up on , because I was thinking about the impact of the SIS legislation on competition, which is one of our main briefs and your submission addresses that and the impression I was left with is that by and large SIS has not been particularly anti-competitive, in fact you say at times that it has promoted and fostered competition, although you do mention that its increasing complexity can be said to be anti-competitive in the sense of adding costs and just making it terribly difficult for people to understand a prudent management framework.

You also say in one point that you think that the legislation might have constrained product development because of the way the legislation is cast. So thinking particularly about the benefits for members of the legislation and the competitive environment, I was just wondering if there were any points you would like to emphasise about the SIS impact on competition and if in particular you had any examples of where it might have constrained product development to the detriment of the community or members of super funds, I would find that interesting.

MS ANDERSON: Can I first make a point which occurred to me as you were speaking there, in that SIS is actually doing two things and I think this is why we are always having to think about what it's doing. It's regulating the industry in a sense that we would see with managed investments of any kind, but it's also regulating the government's retirement income policy, so that when we talk about who can contribute, when you can pay out; all the preservation rules and all those sort of things, that's very much tied up in government policy about their retirement income system, rather than the product, if I'm making any sense here. So sometimes for example when we talk about it limiting product development, I'm not sure whether we are talking about the provisions that relate to the government's retirement policy or the provisions that relate to the prudential management of the fund.

For example, all of those areas around the poor old over 60s I think are to do with some fuzzy thinking about where the retirement income policy is going, rather than prudential or consumer protection. So that's a bit of a dilemma in SIS. You have to sort of see what you are trying to do for the retirement income policy and what are you trying to do for the consumer and for the prudential regulation of a whole mass of money. If you look at those over 60s, then to some extent I think it's preventing perhaps product development in that area where people may in fact want to be taking a drawdown of money while they are still in part-employment. There are all of those things where somebody who doesn't want to fully retire may be working for blocks of time in a sort of consultation process and that's not even at the sort of professional end often, it's where people manage to get a block of work for a period of time and then are out of the work force and want to be out of the work force for months.

My standard line here too is that sort of sometimes the clergy are caught in this problem where they go on locum for a number of months and those assignments are not regular and the legislation doesn't deal with that sort of issue and therefore it probably doesn't deal well with the kinds of products that might be suitable to phasing in retirement.

MR COSGROVE: There is also an issue with product development where you have an interaction between social security legislation and taxation legislation and SIS legislation of the types of products which can be provided with superannuation money to receive particular benefits under each one of those systems and because the legislative interaction of those three pieces of legislation is not particularly good, there is a real inhibition there of being able to develop products which are far more attuned to what people want today. With most pensions they have a notion of lifetime pension with a guarantee of greater return, which effectively mandates that you have to invest in almost capital guaranteed type assets, whereas with increasing longevity one would be recommending that maybe growth assets are an appropriate investment base for these type of assets.

If you are going to invest in growth assets, then you need to have a system which will accommodate greater fluctuations of drawdowns from year to year and as such accommodate people being able to, say, move in and out of the social security system over a period of years as those incomes fluctuate and we don't think that the current arrangements actually cope very well with that type of idea.

MR COSGROVE: Is it possible, Robert, to identify which of those various pieces of legislation that you mentioned is most responsible for that constraint? Is it SIS or is it the tax legislation or is it all of them? I mean, an overall review would probably be able to identify exactly where the problems were.

DR ANDERSON: Yes, but I think that's the point. I mean, you're probably aware that ASFA has been calling for a review of superannuation and particularly in some ares, not necessarily a review because SIS isn't working well as a whole. It has never been, I don't think, in our sights, but there are certain areas. When we talk simplification we're often talking more simplification in the tax area than in the SIS area although there are some areas there that you could identify but they're not major like the tax ones are. We're talking adequacy, which is sort of like more your super guarantee than what we're looking at here today. Then we're talking integration. As Robert says, when you're talking integration you're actually talking SIS, Social Security and tax and we're in the process of writing yet another paper on integration and every time we do it, it is a very difficult paper for us to write because it's difficult to identify who is the main culprit for the problems. But certainly notions of what is a complying pension to get different tax treatment or what is a complying pension under various different pieces of legislation with different objectives, those sorts of areas I think need to be well and truly teased out and dealt with.

MR COSGROVE: Anything else?

MR FRENEY: No, only perhaps one almost obverse point but it was a good one that you made, I thought, about the relative freedom for trustees making investment decisions and how that compares with some other countries. So you get the terribly important point about the accumulating rates of return, compounding rates of return, being so beneficial to members and you actually say that the Australian rates of return are better than in many other countries with tighter restrictions. It would just be very interesting if you have any examples of that you felt able to give us later that would just support that point. I think it's a very valuable one for us to be reminded of.

DR ANDERSON: We will look for some numbers and pass them on to you but it is a point I think we'd like to stress here, that that part generally works well and where there are constraints we agree with the constraints. If in fact you started to mandate how we were to invest, I think we would be taking a step backwards.

MR COSGROVE: On the costs side, Michaela, you mentioned in your opening remarks the fragmentation of the legislation problem and the submission goes on to refer to the FSR Bill and another bill that I hadn't been aware of, the Financial Services Collection of Data Bill. Your argument then runs along the lines that this growing array of legislation increases the complexity of the compliance task and creates a potential requirement for funds to resort to external experts and so on and increases the chance of inadvertent noncompliance. I was wondering how significant you think that problem is. Is it an irritation or is it a serious issue for trustees in their task of complying with the legislation?

DR ANDERSON: I think at the moment it's probably - I mentioned at the start I think we should register that there's a trend here but I think it was fairly comforting when you had SIS and a couple of bits that were associated with it. You know, there were a couple of other acts but it was a nice neat package and I think just the physical fact that it was a nice neat package gave comfort that you could be across everything that was happening. If there were changes to it you could register. It was a change to your act. What you've got now growing is requirements for running a super fund which are now in a number of different acts and that doesn't build confidence in trustees. I hear it from trustees that there's a fear that you will miss something. Something will change and you'll miss it because it's all over the place and I think at the moment that fear is probably a bit exaggerated.

It's not all over the place at the moment but it's potentially going to be and yes, I think that will cause costs because when you've got trustees who feel they can't - you know, like any board of directors, when they fear that they might miss something what do they do? They go and they get legal advice which is costly, to watch for them. So I don't think we should be developing a regime where you actually have to pay people to watch to see what is changing in a number of different areas. I think that's a very silly way to go.

MR COSGROVE: Coming back to where my questioning began, if we're moving into that kind of world is there anything to be said for a shift in the spectrum of management of superannuation funds towards what you might call the professional end as distinct from the - - -

DR ANDERSON: They would do the same. I mean, I think they would do the same. All you would have then would be more people on your staff who were watching. I mean, I don't think you're going to make any difference in lots of ways, whatever - if you've got superannuation funds which will of necessity, because it's compulsory; because it's part of the government's policy agenda for an ageing population, all of those reasons, superannuation is always going to be separate, a bit different. It's going to have to have more overseeing if you like than other managed investments where people choose to go in. Even if you have choice of fund, people have to choose a fund. They can't choose to go and do something else with their money. They have to put it in for retirement savings so there will always be differences, if you like, around superannuation.

So whether you've got professionals - whatever that might mean - and I'm not quite sure, I think whoever is running things, you've got a board of directors of some kind who have advisers around them who have various skills so I don't know that there's an argument there but trustees have to keep their eyes on the beneficiaries. That's one thing - you know, the beneficiaries' rights are the all-conquering purpose.

MR FRENEY: Could I just ask a question, John, in that area. Michaela or Rob, I was just wondering if you were aware of anybody having attempted to sort of measure the incremental cost of SIS so to speak? Perhaps to give a little bit of background of my impression, my impression is that it's very difficult to measure the incremental costs or the marginal costs of SIS but the anecdotal information I've picked up is that while it is something to watch and it's not insignificant, neither is it necessarily pointed at as being exorbitantly large and people in fact point to some other elements of costs such as some of the tax angles that perhaps exceed the costs of the prudent management type parts of SIS. I was just wondering if you were aware of anybody having tried to get any quantitative measures of this or whether you had any impressions you would like to share with me about it.

DR ANDERSON: We've done some surveys on management costs and I can send those to you. Getting organisations to break down where the costs are is sometimes quite difficult because they don't necessarily make a distinction between compliance with taxation which I think has been quite extraordinary in some areas, and compliance with SIS and again some of the areas where perhaps unnecessary costs have been incurred have been where the SIS provisions are to do with the government's retirement income policy side of it; the standards that relate to that part of it, not the prudential, and where in fact the regulator has taken certain views about how they should be undertaken like weekly tests for somebody over 60 who is - you know, some of those sorts of things which people see as costs that shouldn't be there, we should be able to work it out better. We should see the trends in the population, how people are working. We should be able to do this in a much more cost effective way.

But generally, as far as compliance costs go, I think we're fairly aware of the fact that when you have this very heavy burden of participating in the government's retirement income policy if you're in the superannuation industry, then you're going to have compliance costs because you're not only minding people's money but you're minding it for the future and you know, you're sort of part of a national structure. So I think it is costly but I think there's also a sense in which people who are in the industry, the superannuation industry, also recognise why.

MR HODGE: Some anecdotal evidence that I have from conversations I've had with administrators of funds is that the uncertainty of how the new strict liability penalty regime will be implemented through the lack of guidance from APRA, exactly they are going to formulate their view on when to apply what particular penalties, is a cause of concern for administrators when they find there are minor breaches of the prudential requirements because they are uncertain as to whether they should take minor action to correct it and fix it up or they should take major action to redress a whole issue.

Examples would be where an annual statement to members may contain one piece of slightly incorrect information. The issue becomes one of, do you have to reissue all of that information or can you correct it by some other means. Where there's uncertainty about how penalty provisions will apply, that impacts on the minds of the trustees. It has a tendency to cause them to overreact to what are invariably only very minor breaches of prudential regulations and this is also associated with an increasing trend on trustees to undertaken extensive prudential audits bringing in external professional advisers to conduct these audits to ensure they are not in breach of SIS. So it all impacts; so as things become more complex there is a tendency to have a bit of uncertainty and then the follow-on is the trustees then need to seek assurance that they are actually complying.

MR COSGROVE: That's an interesting point. Is that problem a function of the way in which the legislation is applied as distinct from the problem of the legislation itself, regulatory uncertainty on account of implementation practice?

DR ANDERSON: I think we have more issues with the implementation than the legislation itself and that goes to the fact that you've got two regulators, the point we make in our submission, and they can both have the same issues that they're interested in, for example, how does the trustee handle the outsourcing arrangements of their administration. You know, outsourcing might be what they're interested in but it might be for different reasons, prudential or consumer signs but from my own experience you can have APRA turn up one day and ask the questions. You can have ASIC turn up three weeks later and ask the same questions of the same sort of interest in, you know, how are you handling your contracts with your service providers and how are you monitoring and how are you doing all of these things that trustees have to do. It would have been quite nice if they had turned up together.

MR COSGROVE: That's another part of your submission that I was going to come to. I think you've mentioned in writing the point you've just said to us, Michaela, but it may be that the examples are examples largely in that area of outsourcing that you've just mentioned. Your submission does mention that there have also been occasions where independent reviews by both ASIC and APRA have failed to clearly establish whether a breach had occurred and who had jurisdiction for the alleged conduct. Could you explain to us the type of situation that's involved there?

MR HODGE: The issues becomes where there are prudential concerns about, say, a trustee and the concern could be in the administration of underlying trusts or the concern could be in issues concerning the investment of money. The concern could be in matters of what investors were told when they moved into the trust. So where you get concerns that range across there and issues are raised by consumers the question becomes, is it an ASIC-type issue because there are claims which are made to consumers about what was going to happen or is it an APRA issue in that when moneys were received they were not dealt with appropriately.

MR COSGROVE: Under investment rules?

MR HODGE: It could be under either. It could be under either investment rules or it could be under trust rules. APRA might take an interest if they believe that trust moneys have been inappropriately dealt with but then if the issue relies on how the money was invested and the manner in which the moneys was invested then that is investment rules which has a tendency to maybe fall under an ASIC-type arrangement depending on who and what entity the money was invested with.

DR ANDERSON: And here it may be that APRA may be interested in the fact that there was a conflict of interest around the trustees who were trustees of the superannuation fund but were also trustees of other non-superannuation funds and that there was a relationship between both of those and that this is an issue that has now come to ASIC's ears because of complaints from consumers about what has happened to their money. There is a difficulty here about who is going to act.

MR HODGE: That problem arises when you have a single piece of legislation which covers issues which can be addressed by two regulators and if it happened to be a situation where a third entity was involved which had ATO involvement in it then you could have potentially three regulators looking at the same issues with the same entities because the ATO may have an interest that the underlying entity may have breached the complying tests, for complying superannuation funds, and therefore you have taxation issues involved. So the issue is where one regulator goes and has a bit of a look and steps back and says, "Well, it's not really ours," does that regulator then have a duty to pass information on to a different regulator for them to have a look or would better results be achieved at an earlier state if a confined approach had been made by the regulators to look at an entity and concern jointly but from their own vested point of view of what they want to regulate; whether that would actually end up in a speedy resolution of the issue and perhaps prevent further losses occurring.

MR COSGROVE: If we leave ATO to one side, are the operations of the other two regulators capable of becoming more effective from the point of view of the trustee through, let's say, stronger coordination of some kind or is the problem under this structure more intractable than that, in that coordination by itself might not be sufficient to alleviate the problems faced by trustees in compliance?

DR ANDERSON: I think we could try coordination as a first step because I think we concede lack of coordination so you can't - - -

MR COSGROVE: At present you think there's lack?

DR ANDERSON: So you can't rule it out, you know, if we just had better coordination. I think we've seen this fairly publicly recently in the superannuation industry and I think speedy action would have been found if we had had better coordination.

MR COSGROVE: Related to this was a statement in your submission about APRA and ATO having different interpretations of the SIS Act and perhaps the regulations in respect of small APRA funds and self managed superannuation funds.

DR ANDERSON: Yes. This is a sort of pretty classic area I think in that the rules if you like for both of these, whether you're a small APRA fund or a self-managed fund, are really not so different except that you're minding your own or the trustee. But basically what happens from there is pretty much the same. APRA puts out its own circulars and it very clearly states in its disclaimer that this is about the things that - the organisations that we're regulating and not about any of those others. The ATO doesn't put out anything so there's a gap, if you like, there and from observation at meetings I would suspect that coordination between the regulators there is not as good as it could be particularly around the area of them putting out an interpretation of what they think the legislation means.

You could in fact, as I think we say there, have quite a lot of confusion in the industry and distinctions made that the legislation doesn't anticipate. I mean, differences in the way the trustees of either of those are administering the fund and I don't think the legislation ever meant that to happen: who was the trustee is the difference but what can happen, what you can do and when and why as a member of that fund shouldn't differ.

MR COSGROVE: Our terms of reference don't allow us to look at self-managed funds. Is there a problem here in terms of difficulties faced by people who are in self-managed funds but maybe wanting to become small APRA funds, but they're not quite sure whether they should do so because of a lack of clarity.

MR HODGE: Historically we had a class of funds which were called excluded funds and they had existed for a period of time under the SIS legislation and a body of circulars had built up which applied to those entities. Those entities were split into two groups: the SAF, Small APRA Funds, and the SMSFs. When the split was made basically the same provisions of the legislation applied to both groups of funds. They are just regulated by different regulators. The body of knowledge and the set of rules which had built up carried forward. The ATO have not issued anything which changes the rules regarding SMSFs that applied to excluded funds.

In recent times APRA has begun issuing minor alterations to its interpretations of certain of those rules which apply to both entities. As you start to get divergence in the marketplace you have a difficulty with administrators who administer for both types of funds of having to apply different sets of knowledge. As this builds up complexity it increases the costs of administering it because the administrators have to take more time in considering issues. They have to apply different standards in different situations and because you need an increased body of knowledge to understand how the whole industry operates, that in itself creates a barrier to competition because you have a higher threshold of knowledge level before you can become a player in the industry.

MR COSGROVE: This can reveal itself in higher costs paid by small APRA fund trusts?

MR HODGE: No, because the higher costs are actually paid by both because it's an overall higher industry cost and ultimately the costs of the industry are borne by the members.

MR COSGROVE: I understand that. I was just trying to clarify that the costs are spread across both types of - - -

MR HODGE: Yes.

MR COSGROVE: Could I just spend a couple of minutes on this question of, maybe call it consolidation of accounts. I think one of the areas that the community and members at large would get a great benefit from would be if there were easier opportunities to consolidate their superannuation accounts and certainty not wanting to get into the area of choice of funding because that's outside our brief. Simply some of the numbers about - numbers of accounts per person in Australia suggest that there's inefficiencies in the system. I've got a double-barrelled question: one is, is there anything in SIS which actually prevents the smooth consolidation of accounts that we ought to think about and the second one is, I have some understanding that there are some frictions within the systems within the industry that may not facilitate as smooth a consolidation as you might like to have. So I was wondering whether the industry could make some progress on that that would generally help with efficiency from the members' point of view.

DR ANDERSON: I think we were always going to have people with more than one account. I think as the balances grow I think people will not want to have all their eggs in one basket so I think we're probably likely to see a continuation of more than one account for each person. When I did a little count around ASFA staff at one stage I discovered that yes, there was this sort of - behind peoples' thinking wasn't just apathy of consolidation, it was, "I don't really want to move that there because I want to have some there and some there," and there's a feeling of safety in that. These are people generally who have a reasonable amount of superannuation savings and who have moved a little bit around in their jobs, and this is the way they're thinking. So I think, number one, getting one person one account for life is probably not going to be what we'll end up with. Having said that, I think when you're talking about small accounts, yes, consolidation is what you want because you don't want added administration costs from two and that's a different issue from the number of accounts that we have in a mature system. Having said that, I wonder if you've got some thoughts on some of the issues that have been - - -

MR HODGE: You raised the issue of whether the industry can actually do anything to sort of assist this process, and the industry currently has an electronic commerce initiative which is aimed at enhancing the movements of money within the systems between funds, which will lower the costs in doing that. There is also a very good project being undertaken by the Australian Taxation Office which allows a new fund member, on joining a fund, to permit the trustee of that fund to search on ATO registers for other superannuation-type moneys that the member may have and amalgamate them into the fund in which they are joining. The ATO process allows a very cost-effective method of pulling all this data together because they take the data from the superannuation fund, they search across their registers and they provide the information back to the fund.

So you start off with a good body of knowledge from which the trustee can move forward to amalgamating them. So the industry itself, both from the ATO as a regulator and the manager of the Lost Moneys Register and the industry as administrators of people's money, are trying to take every advantage that the new technology provides to smooth this process and enable these moneys to be amalgamated with the single accounts where that is desired by the member.

DR ANDERSON: I think the other thing is too that funds actually like to get accounts consolidated because it gives them more assets. So if you look at most of the material that's given to members when they join a new fund, (1) to help the member consolidate and (2) because funds probably enjoy having more assets under management, they ask on most of those forms, "Have you got any other account somewhere which you'd like us to help you to bring across?" because sometimes, I think, for members with small amounts and not a lot of inclination to move stuff, it's hard for them to take the initiative. So the funds definitely in a lot of cases - in most cases, I argue - particularly looking at industry fund forms now, they will in fact take the initiative for the person and ask them, "You give us the information and we will assist you."

MR COSGROVE: Yes, although I think one of the things that Roger had in mind was the other side of the coin. He referred, for example, that some industry funds might refuse to release an existing member's account to another superannuation fund for periods perhaps as long as six months.

DR ANDERSON: I think there have been some. I think that practice is probably not as prevalent now as it has been in the past but I also think that the reason why that practice is there should be understood. If in fact you are required under an award to make contributions into certain areas, then I think the administration costs of having people in and out of funds when they were likely to be employed in the same industry, was a factor, especially in the early days of those longer periods, and I think some of them were too long. But they did recognise the fact that it was very costly for the member and for the fund and for all the other members that you might have been even - you know, there was a general subsidising in small accounts anyway if people were in and out of funds because of award requirements. Now, I think a lot of that has settled down now and I think you'd probably find that those periods of time are more reasonable. That's my understanding anyway.

MR COSGROVE: On the first barrel of Roger's question, I'm not quite sure I - you may have provided an answer to that, I'm not sure, about whether the legislation itself facilitates movement by fund members from one account to another or constrains it.

DR ANDERSON: I mean, I'll have another think about this and tell you if I'm wrong but I don't think it does.

MR HODGE: And in fact I can recall a change in the regulations being made which actually assisted the smooth transfer by altering the paperwork involved in rollovers where the transfer was done electronically.

MR FRENEY: Yes, that was my overall impression, that there had actually been regulatory steps to try to help this problem - - -

DR ANDERSON: Yes, certainly - - -

MR FRENEY: But I still think from the community point of view it's a quite significant issue and I was just wondering, you know, whether you had any concerns about the legislation about all this.

DR ANDERSON: I think it would be probably not the legislation, not this particular legislation and I think certainly in the rollover situation in terms of tax and SIS, that's being addressed and it continues to be addressed.

MR COSGROVE: I have just a couple of other points to raise, Michaela. One is in your own submission you mention problems associated with multiple definitions in SIS concerning employees and also relatives. I can understand the problem as you have set it out. I'm just wondering whether you can give us an indication of, again, is it a really serious issue or is it - to repeat my word - an irritation?

DR ANDERSON: Probably more the irritation but if you get enough irritations you have a serious issue.

MR COSGROVE: Okay. The other point I wanted to draw your attention was in a submission from another participant - who will be with us later in the day - Mr McAuley. I don't know whether you've looked at his submission. It's number 11. In the course of it he cites a standard 6.00 apparently adopted by IFSA and it goes on to mention that it has several defects in his view. This relates to the presentation of information by super funds on rates of return obtained on members' funds. I don't want an answer today but if you have an interest in looking at that and seeing if you have any reactions to his comments, I'd be interested. But that's all I have. Roger, would you like to raise anything? Nothing else? Thank you. Thank you both very much for coming along and helping us with the inquiry.

DR ANDERSON: Thank you for allowing us to participate.

MR COSGROVE: Thank you.

Our next participant is the Institute of Chartered Accountants. Come to the microphones please. For the purposes of our transcript, we would like you each to identify yourselves and state the capacities in which you're appearing please.

MR RASSI: I'm Richard Rassi and I'm appearing in my capacity as Chairman of the National Superannuation Task Force of the Institute of Chartered Accountants in Australia.

MS ORCHARD: My name is Susan Orchard and I'm the Superannuation Technical Consultant for the Institute of Chartered Accountants in Australia.

MR COSGROVE: Thank you. Richard, we're grateful for the submission your institute has provided to us. Did you plan to make any remarks about it before we discuss some of the matters in it?

MR RASSI: I don't think so.

MR COSGROVE: No? You mention in an early part of your submission - let me pick it up, it's on page 2 - that the members of your institute who act as auditors have reported a decrease in the incidence of significant breaches of the legislation as a result of the consolidation of compliance requirements into one act and improvements in the guidance associated with SIS. Are you able to provide us - not necessarily today - with any actual figures to that effect or is this purely anecdotal?

MR RASSI: I think it's primarily been based on our observations. Also I guess some of these conclusions have come about through some of the members of the committee actually practising in this area. For example, I am the approved auditor of about 600 funds in Australia and so I get to see quite a cross - you know, quite a broad range of funds in my role as auditor of those funds but, no, there isn't any official survey. But I can say that as a practitioner for a number of years in the industry that I have seen major issues declining. It's a combination of things. I think (a) it's a strengthening of the regulators' monitoring of the industry and supervision of the industry but also, I think, a maturing of the industry and an improvement in the standard of trusteeship generally.

MR COSGROVE: If we think about the various types of superannuation funds running from small APRA funds through employer-sponsored funds, industry funds and retail funds and so on, had the incidence of breaches been variable across the type of fund or more concentrated in a particular type than in another or was it pretty even?

MR RASSI: I think it's - obviously at the smaller end there has been some fairly unique type of problems, in particular with the in-house assets requirements, et cetera. But, look, I think it's pretty much spread across and I don't think it would be fair to say that it is the smaller end where all the problems have rested because I've seen problems across the board and all types of breaches cropping up in different types of funds, yes.

MR COSGROVE: Thank you.

MR FRENEY: John, can I ask you a question because that very same comment attracted my attention, Richard and Susan. Could we read from that, that SIS is giving better protection to members than members would otherwise get without SIS?

MR RASSI: I think that goes without saying. I think the framework generally has certainly provided a layer of protection for the entire industry and whilst there are pockets of weaknesses, I think overall it certainly has strengthened the protection for members.

MR FRENEY: Right. So if you're looking to justify the legislation in terms of its aim of giving a sound legislative basis for strong prudent management over and above what would be there without the legislation - - -

MR RASSI: Yes, I think it's achieved that.

MR FRENEY: Yes, and this sort of phenomenon that you've noticed of a decreasing incidence of significant breaches is some sort of substantiation of our view - or your view, sorry.

MR RASSI: Yes, I think so. I think from that point of view it has achieved its objectives. Having said that, there are obviously areas where there could be improvement. There are areas where the legislation may impose additional costs which probably could be removed in a cost benefit analysis. But overall I think the legislation has achieved its objectives.

MS ORCHARD: I think one of the strengths of the legislation is its complete approach in that the legislation has all of the compliance requirements from operating superannuation in the one basis. What we will see with other pieces of legislation starting to diffuse that is an increase in cost and there is risk of compliance breaches occurring as people are unaware of changes which arise in other pieces of legislation. So what we see is we have this strong framework and we are starting to eat away at it now by bringing things in in other areas.

MR COSGROVE: Which other areas would you mention? Do you have in mind for example the Financial Services Reform Bill?

MS ORCHARD: The Financial Services Reform Bill, potentially the Family Law changes and other types of changes like that which diffuse where you go to to find how to pay out a benefit in a complying manner.

MR FRENEY: The national competition principles have a pretty strict criteria that you do away with the legislation unless it can be proven to be justified. So what would be the risks that you would see to members' interests without the SIS legislation? Would you see that there would be a risk of a reduction in prudent management standards?

MR RASSI: Yes, I do, I think particularly in the area of accountability and reporting to members. I think you will find that if SIS were not there that that would break down. That would fall down. I think that is a very significant area.

MR COSGROVE: We need to think when we are asking such questions about what would be there without SIS and in my own thinking the answer to that is probably that you would have OSSRA which preceded SIS. Would you still say, Richard, that the OSSRA was clearly deficient relative to SIS in this area of accountability?

MR RASSI: That goes back a long time. I have to try and thing back in those days when OSSRA did operate, but my recollection of it was that it had a lot of gaps in it. It wasn't strong enough in a number of areas and so there were lots of problems in terms of ensuring compliance and achieving a good standard of prudential management. The focus of OSSRA was not so much on prudent management.

MS ORCHARD: It also doesn't recognise where the market has move on to in a number of areas and SIS has been able to accommodate those changes and one of the reasons for introduction of SIS was to enable a broader availability of products in the market that met the superannuation needs whilst still ensuring that the same regulatory framework was applied to the payment of contributions and benefits across that range of funds.

MR COSGROVE: Yes, that's another issue of interests too as this market for superannuation is a pretty dynamic market and there is a lot of change in other aspects of community life which are having a bearing on it, a faster turnover of the work force from one job to another, an increasing average age of the population and so on. From what you were just saying, Susan, I got the impression that you feel that the SIS legislation is up to the task of responding or accommodating such changes in the marketplace. Am I hearing you correctly or not?

MS ORCHARD: SIS sets a framework for the government's policy on the payment of benefits, the acceptance of contributions and those areas. Aside from that, as long as you are working within those broad policy frameworks, it provides guidance on how you develop your products. For example there isn't a restriction in investments, so areas such as investments can be used to distinguish yourself in the marketplace to other competitor products, but still maintaining that strong policy framework which provides the retirement income goals which the government would like to see in the years ahead.

MR COSGROVE: So in terms of one of the planks that we must address in this inquiry, namely whether the legislation is restricting the entry of new competitors to the industry or the provision of new superannuation products by the industry, how would you see the SIS in those terms?

MS ORCHARD: The restrictions which are being imposed are being imposed by government policy as opposed to the legislation itself. It is the contribution and benefit-type structures which SIS enables which are restrictive and that is policy based, that isn't legislation based - - -

MR COSGROVE: I guess all legislation reflects policy. The question is does the legislation have any advantages or disadvantages in terms of its effects on competition?

MR RASSI: Well, I think generally the answer is no. The costs of complying with SIS are relatively high, but then I think that is justified, given the responsibility that those entities have to the general public. But there are pockets of unfair competition if you like. I suppose the classic example is with the small self-managed funds versus the small APRA funds and how the cost of complying with the small APRA funds has in fact increased as compared to the self-managed. For example, the reporting framework and deadlines that have been imposed on these small APRA funds I think are - - -

MR COSGROVE: For reporting to APRA?

MR RASSI: For reporting to APRA - I think need to be looked at quite seriously, because I think they are causing a significant difference in the way self-managed and small APRA funds operate. In my mind I don't think that difference is justified. So for example with self-managed funds, they have nine months to complete their financial reporting requirements after the end of the year. Some would argue that is probably too generous. On the other end of the spectrum you have small APRA funds whose deadlines have been brought forward from nine months to four months. I as a practitioner have significant concern about that. I think it is imposing undue pressure and cost on that segment of the industry.

You spoke earlier about is the legislation responsive enough to changes and my answer to that would be that I would encourage the principal act to be less prescriptive and the prescription to be moved off into the regulations and the guidelines which are put out by APRA. That is largely the case now, but I think there is scope for improving that balance and getting the prescription away from the main act into the regulations and guidelines, because that would make the whole legislative framework much more flexible and better placed to deal with changes, in particular changes in technology and the way that superannuation funds are going to operate and the impact of e-commerce on the operation of super funds.

MR COSGROVE: I don't know whether we can discuss this in great detail, Richard, but would you have in mind under such a model for example that the parts of the SIS act relating to covenants on trustees and operating standards for funds would remain in the act, or would they become part of the regulation? I am trying to get an impression of what you would see as the new act.

MR RASSI: No, in my mind the covenants would remain in the principal act. I think that's the fundamental framework in which the whole system operates. I think the detail of operating standards would clearly rest in the regulations. As I said before, I think that is largely the case, but I think if one were to look at that and review that you would find that there would be areas where there is too much detail in the principal act.

MR COSGROVE: Some people have put to us and indeed ASFA did in their appearance just before yourselves, that there are some inherent risks in an approach of that kind in that more discretion is placed in the hands of the regulators and as we now have two regulators involved in this industry, there is sort of scope for confusion, misinterpretation on the part of trustees as to what the regulators are really expecting of them. How do you see that issue?

MR RASSI: I would disagree with that view. I think the way business operates these days, it lends itself more to policy guidelines which set the tone, set the expectations of the regulators, are in a position to be modified on a regular basis to respond to the changes. Legislation is inflexible. So the more you can push into regulations and guidelines, I think the better off you are. That's my view.

MR FRENEY: Do you think you would get cost benefits from that flowing ultimately to the members of the superannuation funds, there would be a generally lower cost of compliance structure, Richard?

MR RASSI: I think so. I mean the impact to the members would probably not be that significant, but certainly the trustees and their advisers I think would find it easier to work in that type of framework as opposed to dealing with black letter law which often is open to interpretation and lacks supporting guidance and is inflexible when there are changes. As we all know, it takes time to actually change black letter legislation.

MR COSGROVE: Related to what we have been discussing and another matter which we need to address is possible alternatives to the present legislation. It is again part of the national competition framework that we are operating under. You have covered this briefly in your submission to us. You have indicated there that for larger providers, regulation under a managed investment act framework which I could see is one possible alternative, would reduce the costs of regulation for those people, but would impose restructuring costs on smaller market participants. Could you explain in a little more detail what you had in mind there?

MS ORCHARD: I guess what we were looking at is there are larger participants in the market which are currently operating under the Managed Investments Act, so hence the superannuation pools into a similar framework and would reduce some of the compliance costs.

MR COSGROVE: So they are familiar with that legislation already?

MS ORCHARD: They are familiar with it and they have already got processes and structures in place. What they would be doing is losing one level of regulation and consolidating at the smaller end of the scale. For example the employer sponsored funds, they are not aware of such a regime and the costs of implementing it may lead them to reconsider their place in that market. Whether or not they want to hand over to a larger player, that would reduce competition. Also if they did decide to continue under that structure, they have their restructure costs and implementation costs which are not then spread amongst a number of products in a number of different markets.

MR COSGROVE: They would be once and for all costs, would they?

MS ORCHARD: Some of the management investment costs are one-off set up costs. Others are regular review and compliance-type costs which may be more stringent in some of what - - -

MR COSGROVE: Yes, I understand that, but then the question becomes one of would the costs of complying with a managed investment-type structure be greater or less than those of complying with the existing SIS act?

MR RASSI: As auditor of both types of entities, I think the cost of complying with MIA would be more so than SIS. That would be my initial reaction to that, although I haven't sat down and studied and made detailed comparisons of time and cost, but that would be my perception. The compliance plans that managed investment vehicles have to prepare are quite comprehensive and onerous to prepare and they have to be audited annually. I know from the fees that we charge in terms of auditing those compliance plans, it is fairly high compared to the cost of conducting a compliance audit for a superannuation entity. It would be significantly more costly.

MR COSGROVE: Even for let's say a large corporate fund or a big industry fund?

MR RASSI: Yes, it would be significantly higher.

MR COSGROVE: I guess in this area again, Richard, it doesn't have to be necessarily one or the other model. You might need to stick strictly with the SIS or move entirely to an MIA-type structure. You could perhaps for the reason Susan was mentioning - well, this is a question. Could you let the larger players who are already subject to the MIA conduct their superannuation fund business under that act while leaving others presently who don't have any requirements under the MIA to be covered by the SIS Act.

MR RASSI: That is an excellent suggestion and one that I support entirely and in fact there is evidence of that occurring already. I've got a number of clients where they've got products that are covered by MIA and they have superannuation entities covered by SIS and they are using the MIA requirements to operate all of those products because the MIA framework is seen to be quite comprehensive. It's a solid framework: annual auditing process in place and that's what a lot of players are actually doing. They are extending the MIA compliance plans to also cover superannuation entities even though the law does not require it to do so.

MR COSGROVE: I guess you would need to tack on a few elements though, wouldn't you, like preservation and maybe contribution rules and - - -

MR RASSI: But they are developing one comprehensive plan starting with the MIA compliance requirements, adding on to those and coming up with one compliance framework for all the entities that they are responsible for.

MS ORCHARD: The way that SIS has structured it to integrate the contribution rules and the benefit rules into the MIA can actually be done by saying, "These regulations," because they are blocks of regulation within the SIS reach.

MR COSGROVE: You wouldn't need a new amendment to the MIA you think.

MS ORCHARD: There may be an amendment but it would be an amendment that says, "Refer to these regulations."

MR COSGROVE: A sort of one-liner. This is an interesting point. What funds would not be suited to that type of arrangement? Clearly I guess the small APRA funds. What about the employer sponsored funds?

MR RASSI: Probably not, no.

MR COSGROVE: Industry funds?

MR RASSI: Possibly, yes. A lot of them are public offer funds and they are of sufficient size to justify that type of framework. Obviously your master trusts.

MR COSGROVE: What about from the point of view of the regulator? I'm thinking here only of APRA because the FSR bill which relates mainly to ASIC is outside our purview. Would the regulator find this a messy arrangement or would it have any advantages for APRA?

MR RASSI: I don't think so. I think obviously there would be an initial period of education and getting used to the operations of these organisations but I don't think it's a huge task. I don't think it's a huge transition. As I said before I think you'll find it's already happening in some organisations because it costs them a lot of money to have two separate compliance frameworks and if one of those compliance frameworks quite clearly overlaps with another it makes sense to consolidate that and so I don't think it's a major issue. It shouldn't be a major issue for the regulators.

MS ORCHARD: Some of the frameworks are probably already there as well because APRA is also involved in the regulation of the insurance and banking industries which are some of those industries which are covered by MIA.

MR FRENEY: If I could just follow up, I think I follow the gist of what you're saying, that you could have a compliance framework under MIA which then incorporates a SIS-type compliance requirement and so you would get efficiencies from having one compliance framework, particular for the large funds managers. You would still have to observe all of the SIS requirements so that the kind of criticisms that some people might have of excessive complexity and in some cases constraints of the SIS Act don't go away. They would still be there so that the institutions are offering both kinds of products and operating under both legislative frameworks, would still have to do that.

MR RASSI: You're right, yes. There are specific requirements of SIS that would have to be dealt with but there is a hell of a lot of overlap between the principles of maintaining a proper compliance framework for an MIA client versus superannuation products; significant overlap. So there are a lot of fundamental areas that could be consolidated and then the specific requirements added in.

MR FRENEY: Could I just ask a related question in this area of concentration. We're seeing natural trends in the industry towards concentration and the sort of questions John has been asking about might indeed facilitate more concentration. I was just wondering if you might have a comment about risks to members' interests from greater concentration in the industry. Come back and think that the whole thing is about protecting members' interests. In your experience as auditors of superannuation funds would a greater concentration of members' accounts and balances in the hands of fewer super providers have any significance for that risk? Are there certain risk characteristics of the management of different kinds of superannuation funds you could comment about?

MR RASSI: It could do. I think what we're seeing in the marketplace, as you quite rightly point out, is a concentration and a fewer number of service providers, particularly in the administration of corporate superannuation funds. We're seeing a reducing number of providers and so the corporate funds that are there are being channelled into a fewer number of service providers and I suppose that in itself may or could increase risk in the sense that if the one or two service providers didn't have adequate systems then you would affect the whole significant chunk of the overall market. I suppose with concentration there is an increasing demand for service providers to insure that they have proper and adequate systems in place. Also the concentration of course acts to reduce competition which may see the cost of providing these services increase and I have got evidence of that; that the corporate superannuation funds, the costs of administering those are increasing. There are fewer providers prepared to provide that service and so we are seeing the cost of administration increasing which will flow through to the members.

MR COSGROVE: Why are there fewer providers of those services, Richard? Is it because it's being a relatively low profit operation?

MR RASSI: That is the principal reason. I think going back quite a few years there was a significant wave of price undercutting. There was a lot of pressure put on administrators by trustees to force down their prices. That's resulted in an industry that has a very low profit margin; an industry that has a reduced capacity to invest in technology and systems and as a result we have found a number of service providers moving away from that service.

MR COSGROVE: Would you expect to see some renewed investment in the sector if as a result of the present concentration profit levels rise?

MR RASSI: One would hope that would be the case so that if there is concentration and we're getting economies of scale particularly in that corporate superannuation sector one would hope that then profits would start to generate for those service providers and releasing more funds for investment. It's still early days. That move is still taking place and we're still seeing a number of corporate funds moving away to master trusts as well, which is another trend.

MR FRENEY: I just wondered if I had ventured into a very delicate area. Cut me off if I'm going too far but I just thought Richard would be in a perfect position perhaps to comment on this, in that we hear one of the great virtues of the SIS Act is that it sets a standard and quite high set of conduct requirements for trustees and requires all sorts of diligence and prudence by them and by and large we're hearing that's what it's achieving. I'm just wondering, amongst different kinds of trustees whether you would have any comments, again coming back to this area of industry trends and whether different sorts of legislative framework would tend to increase concentration or facilitate industry trends towards any one kind of trustee versus another trustee and what I've got in mind is, say, professional trustee groups who are for profit on the one hand and on the other hand corporate trustees who are not for profit and who haven't necessarily got any particular training but are doing it on a best-endeavours basis.

If you thought of different legislative frameworks that would encourage trends in the industry towards one particular kind of trustee entity versus another trustee entity, in your experience would that have any consequences for the competence and protection of member interests by that sort of push?

MR RASSI: I think quite clearly for the larger end, the master trusts, the public offer funds, the industry funds and some of the very large corporates, there is almost a mandatory requirement to have some sort of professional trustee board in place to run and look after those funds. At the smaller end that's difficult to achieve and in the past it's been typically conducted on a non-profit basis. Trustee's have not been remunerated for their role. I see a possibility of a halfway house where maybe at the smaller end there might be a requirement imposed to have some sort of professional input on the board, maybe some sort of a professional chairperson to oversee the operations of that fund, to insure that the standard, the best practice in corporate governance is maintained. I don't think I have any other comments. I think I've answered your questions . If not I'm happy to take further questions on that issue.

MR COSGROVE: That's fine, thank you. Richard, another interesting point from our point of view in your submission related to the reporting provisions surrounding the governance of derivatives. You describe them - this is the bottom of page 6 - as somewhat costly and could be streamlined. Are you able to help us in terms of how you would go about such streamlining? Sorry, Susan, can you also indicate to us how costly these reporting provisions are. Are they a small or a large cost for trustees?

MS ORCHARD: What we were talking about there is the risk management statement guidelines and some of the ongoing auditing requirements of those guidelines; processes and practices that you need to have in place in order to invest in derivatives. When some of our practitioners came back to us with comments on this that was one area that they said there was a significant amount of information collected, a significant amount of information reported and not all of it was necessarily on one hand. We have the pooled superannuation trusts which have a requirement if they're underlying investment pool invests in derivatives to have all the processes and practices in place and to have what they call a risk management statement. On the other hand we have all the super funds investing in that which have a requirement to collect a copy of the documentation and then have an auditor sign off that they have done it.

MR COSGROVE: Sort of double coverage?

MS ORCHARD: So sort of double covering that type of information. One area would be that it is sufficient for the super trust to have that documentation, to have in place all of the processes that are required signed off by their auditor that they are following those things and that the documentation exists and perhaps not requiring the super funds to have access to that unless they request it and hence reducing the costs of preparation of all those documents and saving the funds needing to have somebody to sign off to say they received it. That's the type of area. Do the trustees, aside from having an agreement that yes, the people that are investing their money, have all that framework in place? Do the trustees necessarily have to collect the 30 pages of paperwork that goes with it to ensure that? Those are the types of areas that we are looking at?

MR COSGROVE: Is this in the category of relatively minor cost saving or more than that?

MS ORCHARD: I think it's one of those things which is an irritation. It's a minor cost saving, but along with a number of other things, those types of savings can add up and even small costs, when all added together, are a burden.

MR RASSI: If I can just add to that - - -

MR COSGROVE: Sure.

MR RASSI: - - - I think for the vast majority of super funds, the risk management statements are really not communicating clearly the risks and the processes involved. They tend to be quite technical and very difficult to get your mind around. As Susan said, they tend to be very lengthy documents. A think a lot of trustees are just going through the motions of collecting all this information, but really not in a strong position to evaluate and challenge what is coming through. I think there needs to be more emphasis on the reporting of derivative exposures to the trustees in a format that they can understand and in a format that they can monitor as opposed to presenting them with a whole framework of how do we manage the derivatives internally. That would be my comment on that.

MR COSGROVE: If I can go to the next page of your submission, this is the section I think at the top of the page about service providers. You seem to feel that the net tangible asset model is ineffective as a form of protection of superannuation assets and you go on to say that what matters really are the skills and systems of the investment manager. You then have something in the nature of a recommendation really that that would be better put in place by regulation of investment managers and custodians by ASIC. "This is increasingly the case for those managers offering both retail and wholesale services." So I got the impression there again that this is a bit of a trend in the marketplace already. I am not quite sure I followed what you were really setting out there.

MS ORCHARD: The example that we were using is that under the net tangible assets model, in order to be an investment manager which invests the super fund's assets, you need to have $5 million of net assets invested in a certain class. If you have your $5 million, we can hand over $100 million for you to invest for us. So what we were saying is that as a measure of protection, it doesn't actually offer a lot, however, if you have appropriate systems personnel in all those areas, a lot of the investments that we were then investing in are being managed under managed investment-type structures. They are being managed in commercially available wholesale and retail products. A lot of the structures for regulation are already there and what we would say is, well, rather than a $5 million or an arbitrary net tangible assets model, perhaps we need a structure like the MIA that looks at the systems and the personnel that you have in place and whether or not you have the skills and the expertise - - -

MR COSGROVE: Sorry, that was the MIA?

MS ORCHARD: MIA, Managed Investments Act has that type of structure in it. so what we are saying is that when you are looking at where a super fund puts its assets, that type of systems and personnel and expertise-type approach is probably more important than an arbitrary dollar figure as to whether or not you have the wherewithal to have those in place.

MR COSGROVE: Thank you. I don't think I have any other questions. Do you?

MR FRENEY: Only one small one which again I would like to ask Richard from his experience of trustee behaviour. This comes back to one of the other acts actually on top of page 9, the Superannuation Financial Assistance Funding Levy Act and you give some comments there on the possible alternative approach. I was thinking actually, Richard, of the current act, the fact that it has never been used and as I understand it, the circumstances in which it would be used I think haven't actually sort of been spelt out in a set of criteria that would be used. We have heard it said by some people that it would be better to have it spelt out under the circumstances in which this levy might be raised to protect member interest. You can see the merit of that.

I was just wondering if you were to do that, if you were actually to spell out the circumstances in which consideration be given to applying the levy, would that change trustees conduct do you think very much? If trustees knew that under certain circumstances the levy could be used, is confined to fraud and theft, if you set out a set of circumstances that said that for certain sized funds or for certain kinds of conduct or for certain situations, certain kinds of funds or loss to members, if you became more descriptive and prescriptive about that, would that actually increase the risk of trustees not being diligent? Is there a moral hazard in there?

MR RASSI: I don't believe so at all. I would say that would be a very remote risk. I think it would be beneficial to know how this levy would apply so that if funds found themselves in this unfortunate situation they would know how to act and what was there to support them. I doubt very much that that would affect the way trustees would conduct themselves.

MR COSGROVE: On the other hand, would you see it as useful for the circumstances under which the levy could be used advantageous to - - -

MR RASSI: Yes, I think so.   I think it should be understood. I think that would be beneficial for the whole industry to know how it would operate and what the purpose of this levy is and how it will be used.

MR COSGROVE: Thanks, Richard. I think that completes our discussion with you, Richard and Susan. Thank you very much for coming along, I appreciate your help.

I think we will take a short break now to allow people to take some sustenance. There is coffee and tea available I think just outside the hearing room, so we will resume in around about 10 minutes.

MR COSGROVE: We will get under way again. Our next participant is the Institute of Actuaries of Australia. We would like you each to identify yourselves and state the capacity in which you're appearing.

MS MARTIN: Helen Martin, I'm the senior vice president of the Institute of Actuaries of Australia.

MR MARONEY: John Maroney. I'm a member of the Institute of Actuaries of Australia.

MR COSGROVE: Thank you for your submission to us in this inquiry. Are there particular points that you wanted to draw to our attention about it or how would you like to proceed?

MS MARTIN: I think we're happy just to take any many questions that you might have.

MR COSGROVE: That's fine, Helen, thank you. I did have a few areas that I wanted to ask you about in this. One was the material you provided about defined benefits schemes which is on page 6 of your submission. You have said there that these schemes are likely to yield higher returns in the long term at least to members and you've cited some work coming out of the Commonwealth treasury's retirement income modelling unit. I think also some US material. We have to take that seriously I guess. What is it, apart from the facts of the matter, about defined benefits schemes that you think produces those types of results? Is the administration of them better? Are they in the hands of professional trustee managers more than other types of superannuation funds?

MS MARTIN: I think it's more to do with how they're invested and the fact that because the investments are driven by an employer sponsor who's bearing the upsides and down sides they're prepared to be a little more aggressive and so they go for a higher - if you look at the asset allocation of defined benefit funds compared to accumulation funds you'll find a higher proportion of growth assets in defined benefit funds so more shares, more property investments compared to fixed interest investments and over the longer term those assets yield higher returns.

MR COSGROVE: Are you talking here essentially about private sector defined benefit schemes because the government sector's experience hasn't been all that wonderful with these. It is improving. There have been lots of unfunded liabilities for a long time.

MS MARTIN: That's true. This would be mainly private sector defined benefit funds.

MR MARONEY: Increasingly the public sector is funding their liabilities directly or indirectly. Queensland has probably been a prime example.

MR COSGROVE: That's right, and moving away from them as well. That was the other aspect that I wanted to ask you about. Notwithstanding this evidence of higher returns to members we have seen for a fairly lengthy period now a move away from defined benefit scheme to accumulation fund schemes. It seems a little anomalous, at least from the point of view of the members.

MS MARTIN: Yes, it does. I mean, there are a number of reasons driving that trend and at the end of the day I guess the potential higher investment return is not necessarily enough to outweigh those other considerations. That includes things like the additional legislation and compliance requirements. There have been issues in communicating effectively to members. There's a perception that defined benefit funds are more complex and hence more difficult to communicate to members than accumulation funds. There's also been a shift in employer attitudes towards the way they reward and remunerate their employees and a shift away from, if you like, the paternalistic approach of the employer bears the costs and the risks and a transfer of those risks to its employees and that sits with a defined contribution arrangement.

MR COSGROVE: You mentioned a perception, Helen, that these defined benefit schemes are more costly to operate.

MS MARTIN: More difficult to communicate.

MR MARONEY: Perceived complexity I think, yes.

MR COSGROVE: Is there any ways in which the SIS Act itself deters trusts from operating under a defined benefit arrangement, vis-a-vis other - - -

MS MARTIN: There are additional requirements placed on defined benefit funds under the SIS Act and particularly in relation to actuarial investigations and certification. Our submission indicates that in general we believe those are appropriate for prudential and member security reasons. I think most of the additional legislative and complexity issues arise from not so much SIS but the fact that you've got SIS, you've also got superannuation guarantee, you've got the Tax Act and you've got the surcharge legislation all of which add a layer of complexity and in the case of some of those in particular like superannuation guarantee and surcharge the onus on defined benefit funds is much more than it is on accumulation funds.

MR COSGROVE: It would seem difficult in the face of growing use of accumulation funds to say that the legislation was in any way distorting competition in the marketplace as between defined benefit-type products and accumulation products.

MR MARONEY: I question that in terms of - I think in a sense the way the legislative environment has unfolded it has actually put providers of defined benefit funds and companies that are wanting to use those at a disadvantage relative to non-defined benefit funds. I think there has been a competitive distortion and that's probably most easily evidenced by just looking at the Australian situation compared to other comparable countries; UK, Canada, US, where there has been a much greater continuation of defined benefits even though they've been going through a number of the changes of legislative complexity, changing nature of work patterns. So there has been a reduction right across the world but much more pronounced in Australia. I think there is something different about the Australian situation that has made it harder for employers or service providers that would like to have the defined benefit as a more viable alternative in the system to actually do that because of the way the environment has unfolded here compared to other countries.

MR COSGROVE: But Helen's remarks would seem to say that was mainly a function of factors other than the SIS Act itself.

MR MARONEY: I think she was saying it was a combination of SIS, tax, super guarantee, surcharge. When you try and put all those together and try to come up with what is a fair way of changing the rules of defined benefit, each time the underlying legislation changes it becomes harder and harder to do that fairly and do it in a way that is simple for members to understand and to administer. It's not as though, as far as I can see, someone has gone out and said, "We'll make these rules harder for defined benefits" rather than, here is a new rule which is difficult for a defined benefit fund to do because it has the history to deal with whereas accumulation funds have a simpler way of just crystallising all the paths into a single number whereas for most defined benefit funds you need to essentially keep the whole history of for what periods of time were you entitled to a benefit accruing at a particular rate and then it's changed because of super guarantee and then the preservation rules have changed and then some other rules have changed and then some other rules have changed and you have to keep, in a sense, going back through the whole legacy of the membership that was there.

That's much more complicated than in an accumulation fund where generally you're dealing with one or a small number of accounts that crystallise. Well, it doesn't matter what happened in the past. Today's number is X and we move on from there.

MS MARTIN: I think a lot of the policy changes are formulated with a defined contribution or accumulation fund in mind and then as an afterthought there is consideration given to how to apply that across the full spectrum. That again makes it difficult when you're translating that policy into legislation.

MR FRENEY: I think it's a very interesting point that you've drawn out and one that would be well borne in mind about the impact of legislative framework and change on defined benefit funds because in a sense defined benefit funds work to achieve almost a more certain retirement income outcome than an accumulation fund. So if you're thinking of it in terms of encouraging the community to save for retirement and having a known amount of saving at the end of the saving plan, the defined benefit fund, correct me if I'm wrong, sort of actually helps to achieve a certain certainty. Putting it another way around the risk is more with the employer than it is with the employee. So if you did have competitive distortions coming, as I hear it, not so particularly from SIS provisions per se but from the overall framework, it's certainly something to bear in mind.

MR MARONEY: Yes, I would certainly agree with that and one area I think it's overlooked in comparing what is the overall community benefit from the different outcomes is for a defined pension, which is probably the purest form, the classic public service and parliamentary definitions of defined pension, you can insure that the recipient gets exactly the amount defined as required whereas for someone in an accumulation fund to have a high degree of certainty of getting at least that amount they essentially need to fund on average at a higher sort of level. To be 95 per cent confident that you're not going to outlive your money you actually have to save a lot more than what you need on average because half the people will die early, half the people will die later. So you have that automatic redistribution on a needs basis in a defined benefit, particularly a defined pension arrangement, whereas with an accumulation you actually need to save more because you have to save more for the worst-case scenario unless you are going to go and purchase a life annuity which has not been an area that's sort of taken up and I don't think that's under your terms of reference.

The whole absence of the life annuity market in Australia compared to again the UK and US is another major area of inefficiency in the way the accumulated savings are then utilised in retirement that means the money is used for retirement rather than people have to save more and it gets into estate planning and all the sorts of issues which they you build into the legislation to try to manage the avoidance problems of people using the super system for estate planning primarily rather than for retirement income. That leads to more complexity, particularly in tax legislation.

MR FRENEY: Helen, in your submission on the regulation of defined benefit funds you say that they've been in decline in Australia in recent years. "At least some of this decline can be attributed to the legislative framework." Would you be able to hazard some weighting here?

MS MARTIN: It's very difficult because all the circumstances and the reasons why any one defined benefit fund would close to new members or why an employer would make a decision not to have a defined benefit fund is different.

MR MARONEY: I would have thought the only real way to come up with something there would be some sort of international comparison and there's going to be lots of other variables but if you looked at Australia and Canada I think you would be able to say there's a higher weighting in Australia based on the nature of the legislative environment, given we've both probably gone through similar changes in workforce patterns and other ways as far as I'm aware. That would be one way of giving weighting. I certainly wouldn't venture to put a number on it myself.

MR FRENEY: No, the common perception seems to be that it's because of employer preferences as to not having to commit themselves to a defined benefit at the end of the day and funding that. So there's a shift of risk as we were saying earlier but if the legislative framework is also contributing to this then it's an interesting phenomenon.

MS MARTIN: I mean, wearing my consulting hat rather than my institute hat, the work that we do with employers in terms of when they're looking at either introducing a superannuation arrangement or changing a superannuation arrangement there would be a number of issues that would come up on the list of advantages and disadvantages of why we should go one way versus the other and legislation is definitely on that list. It would vary from employer to employer how high it was up on the list of issues.

MR COSGROVE: Of course one of the $64,000 questions for us is raised at the end of this section of your submission where you say you would support simplification of the legislation to reduce some of the additional burden on defined benefit funds. Are you able to give us any guidance on how we might do that or investigate that?

MS MARTIN: I think we've probably touched on a few of the items in other sections of our submission. I think some of the member disclosure requirements for example and the issues around annual reporting to members and the production of member benefit statements and - - -

MR COSGROVE: I think they're probably outside our purview now in the FSR Bill in the parliament.

MS MARTIN: That was one of our difficulties in framing this submission; a number of the areas that we would suggest be simplified probably fall under the super guarantee legislation or the Tax Act or the surcharge legislation. There are some fairly technical issues around, for example funding insolvency certificates which is a SIS Act issue; some of the requirements for replacement and reissue and the timing of funding insolvency certificates is complex and I think as is mentioned in here can lead to the need to get a replacement actuarial certificate unnecessarily. There is not a lot of flexibility for example in terms of whether you do or don't have to reissue. If something happens you're forced to reissue even if nothing has changed and there's no need to do any extra work. It would be along those sorts of lines I think.

MR COSGROVE: Yes, well, I guess you've just been addressing - now that I look at my notes - what I was going to raise next which was the material on pages 6 and 7 about too much black letter law and so there are some, notwithstanding the reporting to member burdens, elements other than that in SIS as you were just saying which you think could be made better. Another question in the very next section actually, the trustee structure section concerned about the burden of more and more legislation, the complexity of it, the recent strict liability changes making it more difficult to find unpaid volunteers to act as trustees so any review should seek to simplify the legislative framework to ease the compliance burden. Does this particular section raise in your mind additional issues other than those that you were just mentioning to us as regards burdens on trustees resulting from the legislation?

MS MARTIN: Only to the extent that it brings in the issue of the representative trustee system and the fact that - certainly anecdotal evidence suggests that it's getting more difficult to get members to stick up their hands to act as trustees of superannuation funds and I think one of the reasons for that is that superannuation is quite scary to a lot of members because it is so complex and it changes all the time and there's a feeling that they just could never have sufficient understanding or be on top of the issues to act effectively as the trustee. So the extent to which you can simplify the superannuation system as a whole, including SIS, would be beneficial in terms of that aspect.

MR COSGROVE: The recent strict liability changes, how do they weight in terms of these sorts of worries that potential trustees or indeed existing trustees might have about their roles? Do you have any insight on that?

MS MARTIN: When those changes were first proposed and we were giving submissions to the senate select committee I guess we raised a number of concerns about the potentially heavy-handed approach that was being taken with those changes and the increasing penalties that were being imposed in a number of cases for actions that might be beyond the control of trustees like relying on the provision of information from third parties and the like. APRA have indicated that they're going take a fairly flexible approach, I guess, to the application of those provisions which has reassured trustees to some extent but it's still early days and we'll need to see how that pans out over time, to see whether it really does become an issue of major concern, certainly for the larger funds that have good compliance systems and processes in place it's just another one of those, "Well, the legislation has changed. We need to be a bit more conscious of what we're doing here." It's probably more an issue at the smaller end of the market I would imagine.

MR COSGROVE: The next section related to the pension certification requirements and you've mentioned there a series of points as warranting review. I wonder though what the implications of all that might be from the point of view of actuaries and if you had, if you like, a less prescriptive set of arrangements than there are at present would that raise any risk issues from the point of view of the management of superannuation funds? This is a rather technical area that I must admit I'm not really up to.

MS MARTIN: I think probably one of the key concerns that actuaries would have with the different provisions in different pieces of legislation to do with certification of pension assets is a question of interpretation and the fact that you end up having to consider what am I doing this certification for and what are the rules in this particular piece of legislation in terms of what I have to certify and so what does that mean for my assumptions in things which makes it quite a more onerous task, I guess, than it needs be. It also leads to issues in explaining what you're doing to trustees and employers because you certify one on one basis for the SIS Act and then perhaps on a different basis for the Tax Act and you come out with different amounts of assets that need to be held or can be held to that pension asset. So again, it's another one of those example where there are, you know, different views from the different regulators - from tax versus APRA versus Social Security.

MR COSGROVE: For what you would see as no good reason or are there reasons for these differences?

MS MARTIN: Arguably the SIS standard is higher because it has a prudential focus whereas the tax standard - the Tax Office wants to minimise the assets that are held to back pensions because investment income on those assets is exempt from tax so there are slightly different purposes there but I think there is that difference that can be hard for trustees to understand and there's probably a lack of clarify in the legislation about exactly what the standard is and what the requirements are.

MR FRENEY: I take it that you do think it is necessary to have actuarial certificate for superannuation funds that are providing pensions? You're not taking any exception to the fact that you've got one but as I read it you were saying that the recent amendments to SIS and the provisions of SIS now - in one sense it's ineffective because it can simply lead to the question of having lower assets rather than an adequate pension. Is that right?

MS MARTIN: You just reframe the pension and provide a lower pension so that you can provide the certification that's required under the act which seems undesirable.

MR FRENEY: So you think it is sensible and proper to have an actuarial certification process.

MS MARTIN: Yes, I would think so. It's just a question of on what basis. I think one of the other concerns - and I'm not sure whether it clearly comes through here, is that in some circumstances you're requiring a much higher level of assets to be held under the SIS requirement to back those pensions to meet the high probability test that APRA has imposed than is actually required to provide those pensions on an ongoing basis using reasonable assumptions about future experience and so it's an inefficient use of assets.

MR FRENEY: Helen, is that an APRA determination, the 70 per cent probability. Is that an APRA guideline, do you know, or is that something that's set in regulation?

MS MARTIN: The regulation actually refers to a high probability and I guess there has been some correspondence with APRA and discussions with APRA where we've said, "What does high probability mean?" and it has been indicated around the 70 per cent level.

MR FRENEY: Yes, previously I think it might have been something like a "reasonable probability" might have been the phrase that was used and now it has been ratcheted up to a high probability.

MS MARTIN: Yes, high.

MR COSGROVE: Yes, in fact I'm not sure whether it was your submission or someone else's who - yes, in fact I think it's the SISFA submission which also referred to this and argued that this APRA-imposed high probability standard reduced returns for members. Would you see it in those same terms?

MS MARTIN: It could have that effect because you would have to invest more conservatively to be more sure of meeting that liability standard.

MR COSGROVE: Yes, I think that was the nature of the point in their submission.

MR FRENEY: Yes, I have a question. The Encouraging Late Retirement section on page 8, where you're saying that the current system requires some simplification with respect to the age limits and right at the bottom of page 8 you say, for example:

> Up to age 70 there should be no requirement to pay benefits because a member is not working sufficient hours and also up to age 70 all types of contributions should be allowed irrespective of the hours worked.

We're receiving actually quite a number of comments in this area and the gist of the comments is (1) that they're extremely complex and so some sort of simplification is desirable and also the thrust of the comments are consistent with the fact that we've got an ageing population and we've got increasing dependency ratios so that the more that you can do to have money in your retirement is for the good in terms of being an alternative to draining the public purse or having the public purse pay for it.

I was just wondering in connection with all this whether you are aware of sort of life expectancy estimates that would sort of support the whole idea that if you've got a greater life expectancy at the age of 65 or 70 that would be suggesting that you would have greater longevity, then you would sort of be needing greater pools of money to support your remaining life. That would tend to support the whole concept of having clearer provisions and more relaxed provisions without contributing and withdrawing from superannuation schemes. Is there some figures that suggest that there is greater life expectancy?

MR MARONEY: Yes, there's sort of well-documented through government actuary producers, span of life tables of every three years or so and each of those shows a comparative life expectancy based on current data back to the turn of the century and you're pretty much going from where male life expectancy was not too different from 65 - somewhere between 65 and 70 at the turn of the century when 65 was put in place under original sort of Commonwealth legislation and has pretty much stuck there since the aged pension system was sort of brought in as a defined number whereas sort of now it's up to around the 80 mark at the 65 sort of level so you've had an increase of probably around 10 years over the century but with no adjustment to essentially 65 being sort of normal retirement age.

So a system that was originally constructed when life expectancy was between 65 and 70 is now being applied when life expectancy for those people that get to 65 is around the 80 mark. So you're really looking that it's 10 years out of date so you can push it from 65 to 75 or at least this is saying move it in that direction and you substantially deal with the majority of the problem because there's not that many people in Australia working past 70 but there's a substantial proportion that do want to have some part-time work and probably increasingly. So between 65 and 70, even if over time, it would probably make more sense to track that age with the actual experience of projected increases in life expectancy.

MR FRENEY: That's an important point. As you've got an ageing population, more and more people are going into older-age cohorts. If you measure it from somebody having reached the age of 60 or 65 say, you can measure quite clearly that they've got a lengthening life expectancy.

MS MARTIN: And certainly for each year you survive as you get older your life expectancy extends even further because you're obviously in good health so I think statistics would support that your life expectancy actually continues to extend although it might be only by a short time as you get older.

MR COSGROVE: I guess one of the potentially difficult aspects of this relates to another important topic which we're not allowed to touch and that is possible revenue implications of such an increase in the eligible age for contributions. I don't pretend to understand even the present system, let along what the consequences of a change might be but you could see circumstances in which a quite elderly person might be able to make large superannuation contributions simply with a view to passing on that tax-favoured investment to their dependants. But I guess it's not fair to ask you for an assessment of the merits of this proposal in those terms?

MS MARTIN: No, I mean, I think though that's why we would support having some age cap on the ability to make contributions and an age by which you had to start drawing down your benefits to limit the extent to which you could do that, and 70 is a reasonable age and arguably it could be even a little higher. In terms of the revenue implications, I thought that ASFA had done some work on assessing what the revenue implications might be of removing that. I don't know how detailed - it might have been a fairly broad brush but I thought they might have done some work in that area.

MR COSGROVE: All right, thank you.

MR FRENEY: I suppose it's coming back to the big picture of the institute's judgments and coming back to your covering letter, Helen, about the overall need for SIS and whether SIS does the job and whether there'd be any better way of doing the job. Have you got any overview comments you'd like to give in that area?

MS MARTIN: Probably not much beyond what's in our submission. I think our general view would be that SIS seems to fulfil a desirable role in terms of prudential regulation of superannuation funds. I think a number of aspects of it are good but I think when you get down to some of the details and, more particularly, it's interaction with the other pieces of legislation that govern superannuation, that's where there's room for some streamlining and simplification that would be beneficial.

MR FRENEY: Thank you.

MR COSGROVE: I think that's all we wanted to discuss with you this morning. Thanks again for your submission which we'll be giving further attention to as we go through the inquiry.

MS MARTIN: Thank you.

MR COSGROVE: Thank you.

MR COSGROVE: Our next participant is the Small Independent Superannuation Funds Association. Are people here? Yes, I see. Would you also, as we've asked others to do, state your names and the capacities in which you're appearing please.

MR McDOUGALL: Thank you. It's Graeme McDougall, Chief Executive Officer of the Small Independent Superannuation Funds Association.

MR LORIMER: My name is Michael Lorimer. I'm a director of the Small Independent Super Funds Association as well as the chair at the Policy Development Committee.

MR COSGROVE: Thank you. How would you like to proceed? Graeme, did you want to make some opening remarks or - - -

MR McDOUGALL: Well, I'd like to ask if Michael could make some opening remarks and then I might just follow on with a few others, and we certainly appreciate any questions you have.

MR COSGROVE: That will be fine. Go ahead.

MR LORIMER: Thank you. I think our written submission fairly much summarises our views and perspectives on this current inquiry but I think it's fair to say that we generally suggest that, looking at the SIS Act and its related regulations, we have a fairly sound framework for supporting the broader policy objectives of retirement incomes. Having said that, the major issue from our perspective is that the legislation, due to its many changes over the last few years, has resulted in it becoming too bogged down in detail which we feel detracts from its fundamental or core purposes. In other words, there's more of a focus on the proscriptive aspects or restrictions in respect of superannuation generally than a focus on what is the overall objectives of the superannuation system. At the end of the day it's to provide retirement incomes but there seems to be more of a focus on how complex it is and how hard it's got and how costly it's got as opposed to what it's actually there for in the first place. Having said that, the framework itself is quite robust, we feel.

In a similar vein, the legislation itself or aspects of the legislation probably have not changed or have yet to change to reflect changes in the demographics, such as aging population, et cetera. Previous witnesses today have discussed similar issues and it would be fair to say that we feel - and a fair proportion of our submission focuses on some changes that we think would be necessary to reflect those demographic issues. I guess in closing, we found it difficult in putting together a submission on the specific legislation, given that there are so many other related acts and pieces of legislation that have a direct interaction with or impact on the superannuation system. It's very difficult to say, "Does the SIS Act carry out its objectives?" when there are some serious significant tax - Income Tax Act - issues that currently underpin the whole - or are an intrinsic part of our retirement income system. So it's very difficult to look at this in isolation. Having said that, we did our best and just tried - - -

MR COSGROVE: We wouldn't disagree with you.

MR LORIMER: - - - to focus on some of the areas where we think some immediate improvement is necessary and quite possibly logistically not that difficult to implement. Graeme?

MR McDOUGALL: I realise that probably what I'm going to say is outside some of the areas in which you can comment on but I'd just like to expand a little bit in a broad sense on what Michael has said because it really is the nut of the issue, and I suppose in the most plain language I can put is, how can you review an act which is out-of-date in relation to the demographics of the society in relation to the policy framework of that act, and I think really that's what we have to deal with in this question. So why do we review an act that we believe is not applicable today, or more importantly, is not applicable for tomorrow? It was interesting to hear you talk to the actuaries about some of the things like the ageing population - and Michael's mentioned that - and retirement age because the most important thing about the Superannuation Act, it is to create wealth for an individual to be able to provide for themselves in retirement and not be a burden on the other taxpayers.

What worries me is that the policy of the act doesn't reflect that when you look at the fact that only 9 per cent of people who are receiving a retirement income of some form actually live without further support from the government, and that is quite a frightening thought. We have the ageing population and if the predictions are true that we are going to have in 10 years' time two-thirds of the population not in the workforce and one-third in the workforce, then the burden on the taxpayer, thinking back on the 9 per cent, is going to be enormous and when we review the act, we are reviewing it today in the context of how it has performed in the recent times, and I can't understand how we can review an act without looking ahead as to how it will perform when you take into consideration these other issues that we raise.

The other two aspects that I would just like to raise is that I can't find in comparable countries around the world in economies, where the Superannuation Act or the wealth creation structure, which is set up to be able to create an income by the individual for the individual, actually is used as a revenue-gaining source for the treasury of that nation but that's what we tend to deal with in this country. We tend to deal with a policy which is designed for one purpose but used for another purpose, and when you come to try and find out what the offsetting benefits are that treasury receives, that's a figure that doesn't seem to be able to be proven by anybody let alone treasury themselves, and I do question whether or not we should ask the question now, is treasury the right place to have this type of act? Should it be an act in its own right without treasury? Should it be, as it is in many other countries, under the control of the workplace relations or other department, or even to that point, a department in its own right? Because I think we have to ask the very simple question, are we trying to put and encourage people to create wealth to look after their own interests or are we trying to set up an act - and as Michael mentioned, the other acts that go in conjunction with that - as a form of collecting revenue? We would just like to put those comments to you as well, realising the terms of reference that you have before you.

MR COSGROVE: Yes, thanks, Graeme. There are some very meaty issues there which I'm sure may people would love to tangle with but, as you've said, we have some constraints upon us. Nonetheless I think there are some interesting issues within our compass that you've raised. If I go back to Michael's remarks, you mentioned that the legislation has become bogged down in detail. I wanted to make sure that in saying that you meant the legislation itself as distinct from its implementation by the regulator, or is it both?

MR LORIMER: No, there's an element of both but my reference was principally to the legislation itself. Once again I realise - I'll just introduce these comments just to exemplify this point - I realise they're beyond the scope of your inquiry but the SIS Act when it originally came out has retained things like the sole purpose test. It's a fundamental principle to the operation of superannuation, and hanging off that were things like the introduction of investment covenants which was an attempt to codify your general trust law obligations anyway from the purposes of an investment perspective, and in a similar vein the requirement - you know, if you were dealing with a related party, to make sure that the terms were commercial or at arm's length to ensure there was some integrity there.

Originally there were also a couple of specific restrictions, say, the in-house assets which have been with us since AUSA and since when the Tax Act dealt with it, et cetera, but in recent years and using the investment provisions to exemplify this point, we have seen inserted into the act itself - not by way of regulation but into the act itself - even more restrictions on what funds can't do which, in our view, just - it's arguable whether they are justified in the first place but what we consider their effect is that there is an undue or disproportionate amount of concentration on those particular aspects than things like, what is the system all about in the first place? I mean, how important now is the sole purpose test, given that we've got this raft of all these other specific, very prescriptive or restrictive provisions about what funds can or can't do from, say, an investment perspective. It seems to me that there should be more focus - or there should have been more focus on things like the sole purpose test and perhaps, to take a leaf out of the Institute of Chartered Accountants book, who appeared earlier today, look at focusing on say fundamental issues like the sole purpose test and then developing industry standards or guidelines that make it quite clear what they mean and what in practice is appropriate and what isn't, as opposed to having it all embodied in the act itself. It makes it very difficult, once you've got that act, to make changes to it, as you're well aware. It's much easier to have some core principles and then have developed or flowing on from that a framework of guidelines and industry standards et cetera. I think that amounts to a far better system. There's too many prescriptive and restrictive type of issues written out in black and white in the legislation in our view.

MR COSGROVE: Again, if I could try to understand properly the point you're making, you seem to be concerned I think on two scores. One is that amendments to the original SIS Act have effectively taken it backwards rather than forwards and secondly, perhaps even the existing act back there in 1993 might have been too much of a belt and braces approach or is that second point - my interpretation incorrect?

MR LORIMER: No, it's pretty much what I'm saying but what we've seen is that the development of the system has I think had the wrong focus. The focus has been on all the restrictions on activities by trustees of superannuation funds as opposed to the fundamentals. There hasn't been enough focus on what it is the superannuation system is there to ultimately achieve for people and consequently you see that the superannuation system as a whole - I guess just from the community-at-large's perspective - sends the wrong messages. People just hear "superannuation" and think, "It's too hard. It's too expensive. I couldn't be bothered." That's the wrong message. What happened to the fact that, "The system is actually there because we want to ensure that you're going to have some money there when you retire and you're going to have a more comfortable retirement and less reliance on the aged pension." That message needs to be conveyed more clearly than the ones that are currently filtering through.

MR COSGROVE: Yes, I guess some people would argue that the SIS is like it is because earlier experience had demonstrated the scope for malfeasance and that, you know, a very tightly drafted piece of legislation which did impose a lot of prudential controls on those in the centre of the system, essentially the trustees, was really essential to produce the outcome that you were just describing as desirable. But you're feeling that it's too much oriented that way?

MR LORIMER: Yes, absolutely. I accept that there is that argument. We've certainly been involved in that specific aspect over the past few years in respect of some amendments that have happened to the SIS Act and would question the basis for the need for such amendments. In other words, the amendments were explained to us to be necessary based on anecdotal evidence. There was no hard evidence gathered, no physical evidence gathered; simply we think this is going on and if in fact what we think is going on is going on and that's not appropriate, therefore we better change it. I don't think that's the right approach and that was certainly the view that we have taken since our formation three years ago.

MR FRENEY: Would you have an example of that?

MR McDOUGALL: Sort of an example is that if you take the changes to the investment rules of which you're not allowed to talk about, the investment rules were brought in or the changes to the investment rules were brought in because there was anecdotal evidence that said that people were doing the wrong thing. That evidence wasn't forthcoming. When the changes came forward as an amendment to the act, the changes that were brought forward actually contravened the act and still do because what they did was that they allowed a change by amendment, which so often happens in the senate, that an investment can be made as 100 per cent of the total assets of the fund where the act clearly says that the investments of a superannuation fund should be a balanced portfolio. So when you have that sort of end result, which is really a political response to what was a change in the first place that really was based on very poor evidence and that's what you end up. When you base it on poor evidence and you amend an act, you will end up with a problem and that's what happened.

MR LORIMER: Just following on from that, I think one of the consequences of having it all written into the legislation is that we seek - for anyone working in the industry would appreciate that every time there has been one of these changes where you end up with a new set of definitions and technical terms and all the rest of it, many of which don't have any case law to explain what they mean, so there's a lot of uncertainty. Would this be an in-house asset or not? There's no sort of clear guidelines when you look at some of the definitions that have been inserted as to what they in fact would be in practice. I think that is always going to be the risk you run by trying to put too much into the body of the act itself, which we have seen, particularly in relation to those investment issues that Graeme just spoke about.

You could say the same, I suppose, for some of the contributions acceptance rules or benefit payment rules which are perhaps caught up in a bit too much jargon and that sort of business but I would suggest that they're less significant because most of those rules are tied up in the regulations and the use of jargon and those sorts of things are more industry related as opposed to consumer related and I think if you work in the industry that's a consequence of being involved in it.

MR McDOUGALL: Could I just add to that. That was interesting because I think it was ASFA who passed comment this morning in relation to the question of the variation between regulators' interpretation and the point that Michael just raised in relation to in-house asset rules is a classic example where the regulator that we're not allowed to talk about, the ATO, has an interpretation of in-house asset rules which is actually in accordance with the act. APRA have an alternative interpretation of it which they put out as a policy paper and so you have two groups of small funds, one APRA regulated, one ATO regulated, that end up with trying to work out which is the right one. The communication or the lack of communication between regulators was probably one of the things that caused that situation to happen.

MR COSGROVE: But if you move to something in the nature of a more high level act with a lot of the practical detail being left in regulations, wouldn't there be more trouble of that kind for people who have to satisfy regulators?

MR McDOUGALL: Can I suggest that one of the problems we've experienced over the last three years, and particularly with all the changes that are coming through, has been - I come back to the point about the reasons why the changes were necessary and the consultation process that goes on or didn't go on in relation to it. I think that a lot of those potential problems that could happen, as you just described, could be overcome very easily if there was developed a proper consultation process between those involved in the industry and those who were proposing the potential changes. To bring forward a draft legislation and then say have consultation is a fairly negative way to go about it as I see it. You have the consultation first and then you bring forward the draft regulation. Then you have a far greater opportunity of being able to eliminate the problems that you put forward as a potential. What we've seen in the last three years is the reverse, the consultation following after the draft regulation.

MR COSGROVE: No consultation prior to the discussion paper?

MR McDOUGALL: No.

MR FRENEY: I suppose I'm anxious to pick up on a point of Graeme's whereby you were alluding to, in a sense, the multipurposes as you were putting it, of SIS. The clear objective of SIS is to provide a legislative framework for the prudent management of funds. That's what the court says and that's what it is intended to do. It happens that because of tax concessions and the need to define products to protect the revenue it is perhaps a more complicated piece of legislation than in other countries. You were making that comparison and talking about the sort of revenue protection bits of SIS. I was just wondering, Graeme, whether you would think it preferable to try to separate - I think implicit in what you were saying is it would be preferable to try and separate out some - I don't know exactly how you do it, the prudent management aims and provisions of SIS from the other retirement income product-related elements of SIS. Is that what you were getting towards and would you see benefits for the members of super funds, small super funds, in that alternative model?

MR McDOUGALL: No, I wouldn't see the separation of two factors of it. Legislation is brought about initially and should be and always should be amended in accordance with a policy objective and I think what I'm hitting on is the fact that what we are lacking is a policy objective that is looking forward at the future to look at the act in its current form and how it should be in its form to follow. If your policy objectives and settings have been considered and taken into effect and then transferred through into the act, the act in itself will do its job. But if your act doesn't reflect the reality and hasn't had a decent policy review for a long time, then that's when - as you bring about change after change after change and amendment - you end up getting the thing out of kilter.

I just find it very difficult and I understand, Mr Chairman, your problem, but I find it very difficult to understand how you can review an act which is driven by a policy but the policy hasn't been reviewed. That's the difficulty that I can't understand and therefore we're looking at the objectives of: is the act doing its job in its current form? Michael has made the comments and I support those comments that in its raw form, yes, it is. However, the industry and the product development within the industry is looking at what the market is demanding and it's trying to fit that into an act that has not been based on a policy which is reflecting the reality. Do I make sense in that?

MR COSGROVE: Let me try to pin the topic down a little, Graeme. I'm wondering what it is about the nature of the present act that constrains - I think what you referred to earlier as the achievement of a higher proportion of retirees not requiring some degree of aged pension support, for example. Where does SIS fail in that respect?

MR McDOUGALL: The confidence - and Michael has touched on this - in the community about it is fairly low because they see it as complicated. They don't want to discuss it, they don't want to get involved in it. I think it would be fair to say that there's a great proportion of Australian community are involved in the Superannuation Act because they're compelled to under superannuation guarantee levy, not because they want to be in it. Therefore, because they're compelled to and because they find it complicated, they don't take any notice of it. That's reflected by a lot of people - and I think the question was talked about earlier this morning, about people having multiple accounts. They have multiple accounts because they're not interested in accumulating the accounts. It's the people who aren't interested in accumulating the accounts, particularly the young people.

So what you've got to have is confidence in the act by the people. The act has got to have some very clear objectives of what it's trying to achieve and what the benefits are to the individual, to the nation. None of that has been communicated. It's been talked about, and you can read through reams and reams of World Bank and OECD conferences and you can see all that being talked about by others. It is reflected on by Australia, but not much action. So it comes back to this principle of, I believe, "Let's get some confidence in an act that is actually going to produce and has some clear objectives, then let's sell that to the people," and you're going to get over this problem of only 9 per cent who are independent in their own right, because that's what we've got to achieve.

MR LORIMER: Could I just add something there. I think it would be fair to say that when we're talking about in relation to getting the act right or some confidence back in the act it's more appropriate to say more confidence back into the system. Obviously the SIS Act is one of many that make up the whole superannuation system. The issue is that - and Graeme has already said it and I've said it once before - that to look at this in isolation is extremely difficult and doesn't solve the broader issues which, whilst the SIS Act obviously provides the platform or the framework for the management or operation of superannuation funds, to ensure that if they comply they get consequent tax concessions, et cetera et cetera is the one thing, but the reference to confidence in the community obviously goes to the SIS Act but then to all the other ancillary pieces of legislation, that's the major issue.

MR COSGROVE: Yes, I can now see that's the essence of Graeme's point really and, of course, it's a point about which we have to be careful in this inquiry that we're trying, insofar as we're able to, to identify the role of the SIS Act in respect of certain things like competition and costs for compliance. But, if your perception is correct, the lack of community interest in involvement in superannuation may well have more to do with the complexities of the taxation system, the aspects of rules governing contributions and so on, although some of that is in SIS, of course. Okay, let's move on a little. One of the interesting points that's made early in your submission, I think on page 1, you said that because of complexity of legislation, I think, at least from the perspective of small superannuation funds recent amendments adding layers of complexity are stifling competition and opportunity. I think on the basis of your earlier remarks, Michael, you seem to suggest this is quite a significant problem.

MR LORIMER: Yes.

MR COSGROVE: That somehow or other members are getting the wrong end of the stick, so to speak, as a result of these restrictions and the complexity and the returns for them might otherwise be able to be produced at a higher level. Am I interpreting what's said here correctly?

MR LORIMER: Yes, you are, particularly from - our membership is principally in the small fund market and so these comments are - - -

MR COSGROVE: Actually, forgive my ignorance, but would you mind telling me exactly what the nature of your membership is?

MR LORIMER: Principally our membership is not limited to self-managed superannuation funds, it's any small superannuation fund and we have a fairly loose definition of what a small fund is.

MR COSGROVE: I see. For example, would you have small employer-sponsored funds as members?

MR LORIMER: Yes, and small APRA funds and then their providers. So we're an association of both funds and trustees of funds and their service providers in respect of those funds.

MR COSGROVE: How many members are there roughly?

MR LORIMER: Graeme?

MR McDOUGALL: One of the hard things to pick up is that you've got to cross-reference between service providers and trustees. So trustees can be direct members or can be indirect members through their service providers and those figures we don't delve into because we keep the confidentiality of those service provider members. But can I say that the membership covers across the provisions of accountants, lawyers, financial planners, actuaries, fund administrators as well as the trustees of the funds. The association came into being because this sector of the market, which is the fastest growing sector of the market, didn't have a coordinated voice because each of the other professions - and I'm not making any derogatory remarks about the other professions - but each of the other professions had their own area, but nobody actually collected all that information and represented this market segment. It was a combination of many things that actually pulled this whole thing together in 1999 to create that voice.

Can I say that what created it was the introduction of legislation was the catalyst that brought the whole thing into existence. So indirectly and directly we would probably at the moment, as a rough estimate, represent about 50,000 of the 217,000 funds.

MR COSGROVE: I'm sorry, I interrupted Michael along the way.

MR LORIMER: That's okay. The comments that we've made there really follow on from restrictions on the investment aspects of superannuation. Specifically and relevant to the smaller fund market reference to stifling competition and opportunity is to future investment opportunities for small funds in regional communities. We had a system prior to some recent changes where small superannuation funds were a viable and integral source of investment capital in smaller communities in real estate and other infrastructure development. Following some changes at the end of 99 those opportunities had effectively dried up. So that's the reference to - - -

MR COSGROVE: Is this again related to in-house investments?

MR LORIMER: Yes, it was an extension to the in-house asset rules which, in our view, just cast a far too wide a net if you had a look at what the original purpose of the in-house asset provisions were all about which was obviously exposing a fund directly to the risk of an employer sponsor's business. That was the fundamental principle. That has now been extended to the nth degree and it's just totally inappropriate in our view but it really has curtailed future investment opportunities at that level.

MR COSGROVE: Right. The competition effect, the stifling of competition, what did - - -

MR LORIMER: Graeme?

MR McDOUGALL: The competition effect is in relation to the use of trusts. This legislation change brought about the prevention of a small fund except for those that were grandfathered to be able to use a unit trust for the purpose of being able to - for the fund to move money into the trust and the trust then being able to borrow to be able to invest in these infrastructure investments. Now, we, at the time, and still do believe, that that is anti-competitive and discriminatory because a managed fund still retains the ability through a widely held trust to borrow. So what we have now is we have a situation where one class of fund is discriminated against on the grounds that the manager of a managed fund will make a better judgment than the trustee of a small fund and we say that is anti-competitive.

MR COSGROVE: You have, if I remember rightly, this appendix which sets forward a number of proposals relating to acceptance standards for contributions and the like in quite some detail and I appreciate that. But, I think, as I was inquiring of the Institute of Actuaries not long ago, there may well be some significant revenue implications coming out of this or not? If I remember rightly again, I think you refer to the cashing-out arrangements as a suitable sort of control of that problem.

MR LORIMER: Yes.

MR COSGROVE: Are you confident on that score?

MR LORIMER: Yes, we are. We are aware of the argument which is being presented from either a revenue perspective or a so-called estate planning perspective. By way of background the current regime prescribes certain circumstances under which a fund must cash out a member's benefits in terms of a lump sum or a pension which typically result to age and employment status and then at the other end of the spectrum there's also age and employment restrictions on the acceptance of contributions. We feel that it's the end system, the cashing-out requirements that are robust enough in themselves to basically make the contributions acceptance criteria irrelevant that are currently there or less significant.

It's more important in our view to focus at the end so that there is no - provided we have a regime that is robust enough to ensure that there is no indefinite deferral of assets held in the superannuation accumulation cycle, that there's no need to have restrictions in their current form on when the money can go in in the first place or limiting superannuation coverage to just those who either are employed or have been employed or have a spouse or all those sorts of things. In our view, it's better to focus on the cashing-out requirements and we think there's a pretty robust framework there.

MR COSGROVE: This is again another difficult area for us. I mean, on the one hand we're looking at something mandated under SIS which is part of our remit and on the other hand it might have potentially significant taxation implications we're not allowed to talk about. I'm not quite sure how we'll handle that in the end. But, I mean, just as a general comment it seems to me that the inventiveness of taxation accountants and lawyers seems to have almost no bounds and it was with that in mind that I was really interested to see how robust you think the protections might be.

MR LORIMER: Yes, we're confident that the protections are there and would be - but it's obviously an area that in developing this type of a proposal we would want to spend a lot more time making sure that those sorts of issues could be adequately addressed by the relevant government department. Our major concern with the current system is that a person's eligibility to be a part of the superannuation system or the criteria for that eligibility contain a number of inequities and anomalies that really don't have much foundation. I gave the example before that you can arguably now have a situation where a husband and wife under age 65 who aren't employed and haven't been employed for 10 years can each make contributions on behalf of the other to a fund under the eligible spouse contribution rules but a single person in that situation can't. There's absolutely no logic, in our view, to that approach. We accept what the underlying policy was for the eligible spouse contribution regime but we see no reason why that couldn't be extended to someone who is a single person in the same circumstances. That just highlights in our view the inequities or anomalies.

MR COSGROVE: You make a point - I think it's on page 5 - about the role of auditors. It begins actually at the bottom of the previous page, "The audit approach should go a long way to achieving a self-regulating industry." A long way - those words caught my eye; and you "believe that this mitigates the need for government regulators to review or audit funds on an individual basis, allowing more efficient allocation of resources." I was wondering what would actually be the difference under such a process compared to the present situation.

MR LORIMER: Just by way of clarification it's really more of an endorsement of the current situation. I suggest that, going forward, there should be or there will be even an increasing focus on the role that the auditor plays in the whole process. Comments about mitigating the need for government regulators to then intervene or supervise really stem from comments that have been made by the likes of APRA and the ATO at previous hearings that we've been privy to where particularly, say, from the self-managed or small funds market the problem conveyed to us is, "How do we as government agency regulate 220,000 individual funds, how do we do it?" We feel that there's a very good answer in the current structure which has the auditor, between the trustees and the regulators, providing that function. We really think that that's really an endorsement of the system and possibly could do with a bit of tweaking just to make it more robust, but I think that's the answer to the regulator's problem.

MR COSGROVE: Thank you. Then the point to which I referred again I think to the previous participants, about the impact of this high probability actuarial standard reducing members' returns. Do you have any actual evidence of that or is there a logical deduction that I've - - -

MR LORIMER: Yes, we do. I'd be happy to provide you with some after - - -

MR COSGROVE: If you could in due course; yes, that would be helpful to us, I think.

MR LORIMER: Yes, we've got a couple of actual examples of where this has occurred.

MR COSGROVE: Thank you.

MR LORIMER: I guess the issue there is mainly that in structuring one type of an income stream we don't think it's appropriate that three different government regulatory agencies should have different interpretations of the final outcome. I mean, from a consumer's perspective how are you ever going to know where you stand if to provide this type of income stream you have to meet these requirements but the consequences of doing that are adverse; it's ludicrous. It really indicates to us that those departments aren't talking to each other.

MR COSGROVE: I think some case examples of that type would be very helpful to us, Mike, yes. That's all in the nature of specific questions that I had. Roger, did you have any more specific questions?

MR FRENEY: Just one very specific one. On page 2 of your submission on rules governing operations and the small APRA funds you say at the end of that paragraph that you thought there was some scope for the legislation to make accommodation for all APRA funds by relaxing their reporting requirements where it's clear that none of the members are at arm's length in relation to the others. As I understand it, one of the important elements of protection in this is for the arm's length members and so I was just wondering if you think that you can have an effective, practical sort of system whereby there were some relaxation without jeopardising the protection for those arm's length members. Just to comment on that, the regulator would find it virtually impossible to know whether there was a genuine arm's length member or not so that that could come back onto the trustees and there would be a bit of a temptation to fudge it.

MR LORIMER: No, I appreciate that that's an obvious risk. I do recall a number of years ago that - it might have been two or three years ago, that a question was put and required to be answered on a trustee's annual return whether there were any arm's length members in the fund - it was a yes or no type question - and I have a feeling that perhaps the result of that data gathering might have resulted in the current self-managed super fund/small APRA type regime. I appreciate that there could be some difficulties there in providing a system that was robust enough to pick up those instances. I'm certainly not professing to have the answer to the implementation of that proposal at this point in time, but I think the main point to be made here is that from a practical perspective a small APRA fund and a self-managed superannuation fund, in terms of their membership composition and investment profiles et cetera, are more or less one and the same.

The only difference is that one has all of the members as trustees and the other one, for various reasons, has an approved trustee. Their composition and nature and make-up is fundamentally the same and yet the ones that have the approved trustee, simply by virtue of having an approved trustee, are treated no differently really to what an industry fund is, for example, which doesn't reflect really what the - overlaying that is that the approved trustee of those particular funds is itself subject to supervision and net tangible asset requirements and the rest of it by the APRA. If that's the case, the question is, is it appropriate, given that the fund underneath it is no different to a fund that is exempt from a number of these disclosure and reporting requirements, to be subject to the same sort of disclosure regime and other reporting obligations as a large multi-employee type arrangement. Our view - - -

MR FRENEY: I thought the critical difference - excuse me for interrupting - is this question of that the small APRA funds where all of them - sorry, I'll go back - if all of the members are not trustees then it cannot be a self-managed superannuation fund.

MR LORIMER: Correct, yes.

MR FRENEY: So it has to be a small APRA fund.

MR LORIMER: That's right.

MR FRENEY: The issue here is the one of protection for the arm's length member from the trustees who might be tempted to make a decision that does not favour the - or it could be to the disadvantage of the arm's length member. So I think there is a sort of very important difference between small APRA funds and self-managed superannuation funds from that point of view and anything that you do in terms of differentiated regulation has to bear that very, very clearly in mind.

MR LORIMER: I guess a lot of that comes back to what this issue is of what is an arm's length member. Quite clearly, a member of a small APRA fund is at arm's length to the trustee of that fund; that goes without saying. Historically, a member was only considered to be an arm's length member if they were not related to either through blood or business with all the other members or the employer sponsor; so they were a genuine at arm's length from everybody in relation to the fund. Typically you'll find the small APRA fund market at the moment comprises a mum and dad retiree couple who decide - they have had a self-managed fund but just decided they don't want those responsibilities as a trustee any more so they appoint an independent one to carry out the statutory obligations et cetera that are imposed on the trustees. But they still make all the investments decisions, they effectively direct the trustee where they want the money to go, they can still choose their other service providers and all those sorts of things. So their composition and make-up are still very much in the nature of a self-managed fund but, for example, they have to provide the members with comprehensive annual member reports, which isn't a requirement of a self-managed superannuation fund, they have to prepare financial statements as if it's a reporting entity, which you could possibly argue that it isn't, and their whole annual return lodgement timetable is a lot tighter than what is allowed for the self-managed superannuation funds.

There's also the fact that the trustee itself of that fund is subject to prudential supervision in its own right, irrespective of which funds it's a trustee of; in it's own right it is subject to prudential supervision by APRA and it's approval as a trustee can be revoked just like that. So there's that level of protection for those funds as it is. It just doesn't seem to us that a fund of that size or nature should be in the same category as a fund with four or 40,000 members. It doesn't seem appropriate in terms of disclosure and other sorts of issues, and cost, I suppose.

MR COSGROVE: The other issue I was going to ask you about relates to what you will have heard us discussing with other participants about possible alternative regulatory frameworks for superannuation funds. Given the nature of your members, on the basis of what others told us I wouldn't expect that you would be in favour of a move to something like a Managed Investments Act structure because it would mean a fair bit of dislocation, I guess, and rearrangement of schemes for your members.

But what about the other possibility which we raised, namely of letting the big funds, so to say, however one might define those in detail, go into an MIA type of framework while leaving the smaller funds under SIS?

MR LORIMER: We had the benefit of hearing the witnesses who appeared earlier today and my comments in that regard would be that as a practitioner I certainly don't have a comprehensive working knowledge of the Managed Investments Act. I have an understanding of what it's about and the changes that resulted in it, et cetera. My major concern there would be that the whole concept of having a responsible entity could be a little bit at cross-purposes with what a superannuation fund is all about. In other words, it has obligations under the Managed Investments Act to assume responsibility for its compliance and investment aspects and all the rest of it - and I think it was the Institute of Chartered Accountants who talked about how some of the large organisations now are extending their managed investment compliance plans to incorporate superannuation issues. That's probably a good approach in practice but I just don't know legislatively whether it would be appropriate to just refer to bits and pieces out of the SIS Act. There's also then things coming under the responsible entities regime. I think there would be a risk of conflicts of interest or just the whole thing operating at cross-purposes.

I think Michaela Anderson from ASFA earlier expressed that view quite well where she said that the superannuation system is not the funds management system and it can never be because of what its purpose is, the three-pillar approach to retirement incomes and all the rest of it. It really does have some unique aspects that have to be treated very sensitively and separately. I would suggest that that would be the difficulty I would have at any level there.

MR COSGROVE: Do you have anything to add, Graeme?

MR McDOUGALL: If it was looked at, the only other question I would ask is cost. One of the maximum things we should always be trying to achieve in a superannuation system is to minimise the cost so that we maximise the return and I say that in the sense that the principle of maximising the return is to create as much possible wealth for the individual so that individual doesn't become dependent upon the public purse, not in the sense of any other sense but that, and I think that also because of the differences related between the Management Investment Act and Superannuation Act in principle - I see them having two clearly different objectives. One is about long-term savings, about creating an income stream, and we have talked about the need for that to be of more concern because of that life-expectancy problem that we've got coming but the Management Act is more about - to me in rough terms - it's about making money on a quicker basis for other reasons and other purposes, and the last thing I think you should do in relation to the Superannuation Act is confuse people more. They're confused enough. So let's not give them any more confusion.

MR FRENEY: Okay. That's a good point to finish. Nothing else?

MR McDOUGALL: No, thank you.

MR COSGROVE: Right, unless you wanted to make any other points to us, I think we will conclude there.

MR McDOUGALL: Thank you for the opportunity - - -

MR COSGROVE: We are grateful to you for coming along.

MR McDOUGALL: - - - and we also thank you for the opportunity of allowing us to be a little bit broader in our comments.

MR COSGROVE: All right. It was refreshing.

MR FRENEY: Thank you.

MR COSGROVE: We will adjourn now for lunch and we are resuming at 2 pm.

(Luncheon adjournment)

MR COSGROVE: We will resume the hearing now and our next participant is the Australian Shareholders Association. Mr Rofe, would you mind identifying yourself for our transcript please.

MR ROFE: Yes, Ted Rofe, and I'm Chairman of the Australian Shareholders Association.

MR COSGROVE: Thank you. I think we're in your hands - - -

MR ROFE: Right.

MR COSGROVE: - - - as to what you'd like to tell us.

MR ROFE: Certainly. First of all, I'd like to apologise for not having lodged a written submission. I am afraid, possibly due to oversight in our office or something, the inquiry rather caught up on me.

MR COSGROVE: That's okay.

MR ROFE: Perhaps, if it's appropriate, I might tidy up my notes and email them to you later if I may.

MR COSGROVE: Yes, that would be good. Thank you.

MR ROFE: Perhaps if I could start off by giving just a brief background to the Australian Shareholders Association. It's a national body representing individual as opposed to institutional investors in Australia. The ASA has over 6000 members and active branches in all mainland states of Australia. It's a not-for-profit company limited by guarantee and it's funded mainly by member subscriptions. We receive no government or industry funding. The name, I guess, shareholders association, is in a sense an anomaly because since, I suppose, the early 1990s our charter has been interests of investors in all types of financial investment products, including life insurance, superannuation and managed investments.

MR COSGROVE: I see.

MR ROFE: But I guess one of the reasons why we tend to have a higher profile in relation to companies and shareholder activities is because we believe there is a more effective corporate governance structure and accountability by directors to their shareholders than there is in relation to some of these other products, and I guess that's one of the themes I'd like to say something about today.

MR COSGROVE: Mm'hm.

MR ROFE: Just briefly on the scope of the inquiry, although it's stated in the issues paper that matters covered by the Financial Services Reform Bill are excluded, I don't think you can adequately address the issues raised in the issues paper without at least making some reference to the provisions of that bill, particularly in relation to consistency between regulatory regimes and improved coordination to eliminate unnecessary duplication. There are figures in the issues paper about the superannuation industry and I guess some of the key figures that strike us there are, first of all, that at the beginning of 2001 some 98 per cent of full-time workers and 59 per cent of casual part-time workers had superannuation accounts. There are figures given there for the size of the industry and the size of the various sectors of the industry.

I note it stated that as at September 2000 account balances averaged around $22,000 but if you split up the table, I think that's rather biased by the assets per account in self-managed funds, which is about $168,000 on that figure and ranges from around about $6000 for industry funds to $54,000 for corporate funds. And I see that of these accounts 49 per cent, or if self-managed funds are excluded 50 per cent, were with retail funds and 31 per cent with industry funds. However, if we look at the dollar figures, retail funds held 29 per cent or again, if self-managed funds are excluded 38 per cent of fund assets versus only 8 per cent or 11 per cent for industry funds.

So retail funds, I think it's fair to say, are a pretty important segment of the market. No information is given in the issues paper on likely future changes in the break-up between corporate, industry, public sector and retail funds but I think it's likely to be affected by current proposed changes in the regulatory environment including the Financial Services Reform Bill and any legislative changes resulting from this inquiry. I think it's apparent though that both industry funds and retail funds are currently engaged in aggressive marketing programs and whatever the result of that, I think it's clear that superannuation is of major importance, both to the individual contributors and also to the Australian public; first of all because - if not already then certainly by the time they retire - their superannuation account is likely to constitute the second or third largest asset after the family home for most workers in Australia and the major source of their retirement income. Secondly, because superannuation funds form the major and increasingly important source of funds for investment in Australia. The next heading I've got here is criticisms of the industry and I'm not sure whether you're aware of a recent article in the Financial Review by Alan Kohler - - -

MR COSGROVE: Yes, I saw that.

MR ROFE: - - - a couple of weeks ago, where he made a number of criticisms of the current structure and governance of the industry, and particularly referred to an excessive reliance on external consultants, inadequate disclosure of costs, remuneration not effectively related to performance, and lack of accountability to fund members and to the public, and finally, a focus on short-term performance and returns resulting from quarterly reporting.

Phillipa Smith responded to Kohler's article in a subsequent issue of the Review. I felt that she possibly misinterpreted what I suppose you could call his allegorical tale where he compared the industry to a company with directors. She said:

> The strength of the trustee system is that trustees are responsible to the members of funds not shareholders. The primary purpose of trustees is to maximise the retirement income of members not the profit of shareholders.

I think though that Kohler's point was to compare the accountability of a company's directors to its shareholders with the accountability or perhaps lack of accountability of superannuation fund trustees to fund members, and this is, I guess, my point about corporate governance and accountability.

She raised what really I think is a different but equally valid point of the contrast between the responsibility of the directors of a company, which is a service provider - for example, a company such as AMP or Colonial which operates public offer funds - to maximise the return to that company's shareholders with the duties of the trustee of a superannuation fund to maximise returns to fund members. On other hand, she agreed with Kohler's criticism of current benchmarking of performance leading to an emphasis on short-term returns. I would also agree with her point that some of Kohler's criticism relates to fund managers rather than trustees although, particularly in the case of public offer funds there is, I think, a growing overlap between these functions where you've got some of these providers running managed investments and also providing superannuation, and it all comes out of the same group.

In a subsequent article Kohler compared the charges of a well-known industry fund with the typical charges of a private master trust, and I think that does back up what I think some earlier witnesses have commented about: the role of industry funds in providing competition to some of these public offer funds, particularly in the area of management charges and so forth.

I think that's summarised what I wanted to say there. If I could turn then to this question of corporate governance and accountability. We would argue that life insurance, superannuation - and to a lesser extent, managed investment schemes - have been subject to a less effective corporate governance regime than companies, and in particular, public companies. Currently both companies and managed investment schemes are subject to provisions of the Corporations Law dealing with fund raising, financial reports and audit, and meetings of members. A public company is required to hold annual general meetings at which the annual report and financial statements of the company are considered. The members may address questions to the directors and auditors, and the directors stand for re-election. There is, however, no requirement for managed investment schemes to hold annual general meetings although in fact that's something we are lobbying for.

Under Part XIII of the SIS Act trustees of superannuation entities are required to keep proper accounting records, prepare annual financial statements and have them audited but there's no requirement for these financial statements to be formerly submitted to members or for trustees to be directly accountable to members. In our experience, and of course based on experience with companies, the annual report and the annual general meeting provide an important channel of communication and accountability between the directors of a public company and its members, and we believe that some of the issues raised by Kohler could be resolved by greater and more direct accountability by trustees of superannuation funds to their members.

The FSR Bill provides for periodic statements to be given to retail clients who hold, among other things, managed investment products and superannuation products but it's not clear at this stage that the information provided will be as extensive as that currently required to be prepared under either Chapter 2M of the Corporations Law or Part XIII of the SIS Act. There's no requirement under the FSR Bill for annual general meetings of holders of managed investment products or superannuation products.

Turning to some of the issues raised in the issues paper, the first one, Objectives of Legislation - and I guess our point here would be as we see it - we would see the objectives of the SIS Act as being essentially the implementation of a national retirement incomes policy and prudential supervision. Particularly in the light of the FSR legislation, we would see other aspects that are currently covered by the SIS Act going over to the Corporations Law.

Costs of the Legislation, as the issue points out, the act and regulations under review are voluminous, complex and in the past have been subject to frequent change. This not only results in costs to participants in the industry but discourages voluntary participation in superannuation funds and to that extent is contrary to the objectives of a national savings and investment policy and a national retirement incomes policy, and I think Kohler picks up in at least one of his articles the fact that a large part of the growth in superannuation funds is not through compulsory super but through voluntary contributions, and when people are considering investing, if they have got a choice of investing in a managed investment scheme where they can put their money in and get it out versus something that they've got to tie it up for a period of time and then they're faced with every year changes in tax laws, additional complications in legislation, I think that has a significant deterrent effect.

So I think that, if possible, a reduction in complexity and a simplification in the general structure of this financial investment product area would benefit investors in general, including investors in superannuation. I think there is a potential for the FSR Bill through, for example, the introduction of a single licensing regime, to reduce compliance costs and to facilitate a better understanding of and therefore encourage investment in financial investment products including superannuation. Kohler also points out that a reduction in compliance and other costs has a greater potential to increase terminal benefits to contributors than a corresponding increase in contribution rates.

Alternative means of achieving the objectives of the legislation. With the switch from defined benefit superannuation plans to defined contribution plans and voluntary superannuation, I think there's an increasing convergence between managed investments on the one hand and superannuation, both in terms of the products provided and the product providers. I mean, increasingly you'll find people like

AMP, Colonial and so forth, if you go into the office you get a prospectus. One prospectus is for a managed investments product; the other prospectus in virtually similar terms, although it might have a different name currently. They're essentially similar products except from the point of view of the fact that you, in the case of superannuation, are tying up your money until retirement and there's a different taxation treatment. So as I say, I think this convergence is important and I think that it's logical in the light of that to bring certain aspects of the regulation of superannuation under the MIA FSR structure of the Corporations Law.

If we look at the Managed Investments Act, some of the main changes introduced by the act were the replacement of the former trustee and manager of a managed investments scheme by a single responsible entity, the replacement of a former approved trust deed by a constitution and compliance plan and the introduction of a requirement for a compliance audit and for a responsible entity to have a board with a majority of external directors or a compliance committee. What we would be arguing is that that structure is equally appropriate for superannuation funds, certainly funds which have - I was going to say a large membership. I guess I would cross out the self-managed funds and possibly the small APRA regulated funds which, as the previous witness said, in many cases are really just a family fund except that you've got an approved trustee rather than - - -

MR COSGROVE: Member trustee.

MR ROFE: - - - member trustees but where in effect the members are controlling their own investments. I think the key thing is the separation of the ownership of the funds, the beneficial interest in the funds and the management of those funds, and I think for a situation like that the managed investment structure is a structure which is appropriate for both managed investments and superannuation schemes.

Turning to the next heading I think in the issues paper, Legal Structure of Superannuation Funds, we would argue that the trust structure provides a more flexible structure for distributions to members than a corporate structure. The Corporations Law still distinguishes between income and capital and imposes different rules on distributions of capital as compared to distributions of income. A similar distinction is maintained in the income tax legislation. I think the trust structure has been used for many years for both managed investment schemes and superannuation funds and it appears to operate in a satisfactory manner.

There has been some mention of the different terminology between the trustee of a superannuation scheme and the responsible entity of a managed investments scheme, and there has been discussion about the duties and responsibilities of trustees. I would argue that they are essentially similar and in both cases, just as in the case of directors of a company, there is a fiduciary duty on the - whether it's responsible entity directors or trustee to the members, the owners of the funds. I think, as I say, essentially those duties should be similar, whichever type of investment it is.

So I suppose, moving on from that, we would argue that all trustees other than those of self-managed funds, should be subject to licensing under the FSR Bill and that we shouldn't rely on well-intentioned amateurs. I notice some discussion earlier on about trustees of funds not being paid and so forth. That's all very well and honourable but I think particularly when you look at the sums of money involved, really the well-intentioned amateur is not the right person to run the fund. I think there is a need for appropriately qualified and experienced people and I think that can best be served through a licensed responsible entity.

Under the heading Rules Governing Operations, I guess I'll come back to this but we would suggest that the SIS legislation should be confined to the implementation of the retirement incomes policy and prudential regulation, leaving other aspects - and I suppose you would say the general infrastructure - to the Corporations Law, MIA FSR as incorporated in the Corporations Law.

There's a heading there of Investment Rules and again I would support what I think has been raised by a number of earlier witnesses and including Alan Kohler that I think a key thing here is to remove the emphasis on short-term returns and I think if we look at superannuation in particular where typically we're looking at what might a 20 or 40-year investment horizon, I think it's a logical form of investment funds for long-term investments. So therefore I think if we can, with appropriate controls, facilitate a wide choice of investment and get away from this focus on short-term returns, short-term performance, it's going to be in the long-term interests of the fund members and in the long-term interests of the nation.

Administration Enforcement of Act - other witnesses have dealt with regulatory overlap. I guess just two points I would make here, first of all that penalties should be consistent for all financial product providers and I know there was some opposition to changes in the penalties in relation to superannuation. I think some of that opposition was misguided. As I say, I think there should be a common set of duties and a common set of penalties for people who manage other people's money. I suppose the second point I would mention under here, that the loss of complying statement for tax purposes should not apply, should not be used as a sanction certainly in cases of funds other than self-managed funds. I don't think a member of a fund should be penalised as a result of some wrongdoing or mistake by the manager of the fund. In the case of self-managed funds, which are often tax-driven anyway, I think removal of tax concessions might be appropriate there but not for a fund which has a separation of ownership and management.

There's a heading The Superannuation Resolution of Complaints Act - the general principle under the Corporations Law FSR Bill is for internal dispute resolution mechanisms supplemented by an external mechanism. My impression is that the Superannuation Complaints Tribunal seems to operate okay. I guess it does have the advantage of appearing to be an independent body. On the other hand, we have had a number of complaints in relation to FICS and the way it has operated; delays in dealing with complaints, perhaps a perception of industry bias due to the fact that it's an industry-sponsored body, although I understand there has recently been a change in management there and that may make a difference, I don't know. I guess all I'm saying is that SCT seems to be working okay. It does have the benefit of perceived independence.

Superannuation Financial Assistance Funding Levy Act, again I don't want to comment in detail on that. I suppose some of the headings I've got here are one, the question of moral hazard; the suggestion that if there's a fund there waiting to pick up the problems that perhaps might reduce some of the responsibilities. The second point I've got here is HIH and the problems and issues that's raising as to the extent to which purchasers of a financial product should be compensated and if so by whom - by the industry, by other customers and so forth. I suppose the question I've got here is what would be the consequences of the failure of a major superannuation fund? I mean, you would have a lot of people approaching retirement saying, "We've lost 20, 40 years of our savings. We're going to go on the dole." On the other hand I suppose the question is, is this likely? Certainly one would expect the risk profile of a superannuation fund to be a lot lower than an insurance company and it may well be that sound investment policies, appropriately supervised should minimise this risk. I guess that's all I want to say there.

The Superannuation Self-Managed Superannuation Funds Taxation and Supervisory Levy Imposition Act - again I don't want to comment on that other than to refer to recommendation 104 from the Wallace committee that said regulatory agencies' charges should reflect their costs. Regulatory agencies should collect from the financial entities which they regulate, enough revenue to fund themselves but not more. As far as practicable the regulatory agencies should charge each financial entity for direct service provided and levy sectors of industry to meet the general cost of the regulation. Other people are in a better position to comment on whether that system is working at the present time.

Occupational Superannuation Standards Regulation Application Act - again, no detailed comment but it would seem to me that termination of these provisions should help to reduce complexity. I think there has probably been an adequate transitional period there. If I could perhaps summarise our position. We would suggest that ASIC and the Corporations Law incorporating the MIA legislation and the FSR Bill, should regulate what I might call the honesty, integrity and accountability of superannuation funds and the consumer protection aspects; that APRA and the SIS legislation should cover implementation of retirement incomes policy and some of the issues that were raised earlier this morning and prudential supervision; and I guess the key thing here is that because of the long-term risk management function of superannuation as compared to managed investments, you know, I think there certainly is a prudential regulation aspect there. Indeed, I just wondered, because of the common risk management aspects of both superannuation and life insurance, perhaps there should be a single act dealing with the prudential supervision of both these products and administered by APRA, whereas I suppose you would say the consumer protection and infrastructure aspects appear to be now coming under FSR and the Corporations Law.

Then the third, I suppose section of regulation would be the ATO and the income tax legislation dealing with taxation, tax policy and tax avoidance aspects of superannuation and of course small self-managed funds, many or perhaps most of which are essentially tax-driven. I guess our argument would be that better corporate governance and accountability should provide incentives to drive down costs and increase long-term returns. I would suggest that accountability is related to risk. Perhaps in the case of defined benefits schemes where the risk is borne by the sponsor or the employer there should be an emphasis on accountability of the sponsor employer. In the case of accumulation funds where it's the contributors, the members, who are really bearing the long-term risk, that the accountability should be to the members.

Perhaps if I could just briefly go back to the point raised by the Institute of Actuaries where they commented on the apparent better performance by private defined benefit schemes I would suggest that perhaps that's based on the attitude to risk and return, that because there is a responsibility of the sponsor or, for example, the employer to provide a defined benefit there's a stronger incentive to maximise long-term returns and to manage risk effectively for those plans whereas by way of contrast there may be an incentive of trustees of defined contribution and public offer schemes to minimise risk and to maximise short-term returns. I think that might be an explanation of the different performance there. I guess one thing which perhaps needs a bit of attention is this question of the appropriate incentives for trustees or responsible entities, whatever they may be, of accumulation funds to focus more on longer-term returns and a longer-term approach to risk management. That's essentially the theme of what I want to say.

MR COSGROVE: Thanks very much, Ted, for that systematic trail through the issues. You've made some very interesting points and we'll look forward to your tidied up submission. Just a couple of things that it might be worth asking you about this afternoon, the accountability issue is in a sense hard to deny. I wonder though in practical terms how big the benefits of introduction of a requirement to that effect might be. I mean, one thing that it does up-front is to increase the cost structure of the funds. They are going to have to convene meetings in certain premises and pay hiring costs and what have you, prepare more documentation, I would guess, for possible discussion at the meetings. So the question really is, are the members at such meetings likely to bring about changes in the behaviour of the trustees more than commensurate with those direct costs? In a way, that's a bit of an empirical question but you can see it, I agree, as a matter of principle that whatever the costs accountability should be in place.

MR ROFE: Could I address that from two aspects. I know this question of costs is always brought up. I just wonder what would be the extent of the implemental costs. I mean, presumably the funds are required to keep proper accounting records, they're already required to keep proper accounts. Is there going to be a great marginal costs in making those available to fund members? Again, I draw a bit of an analogy here between some of the developments under the Corporations Law - I mean, we've got things like concise annual reports versus full annual reports, we've got options for shareholders not to receive annual reports if they don't want to receive them. So I just sort of suggest that perhaps the cost argument may not be quite as big a bogey as some people would suggest. The second point - and I acknowledge this - about what is going to be the effect of making this information available to fund members - and I acknowledge there as much as anything else there is an education point, and of course this is not limited to superannuation. It's a problem that ASIC is very conscious of - they've issued a discussion paper on it - and of course they're concerned about in some cases what you might call bogus education where people hold a seminar and say, "Look, we'll help you plan for your retirement," when they're really just flogging off a shady product.

I think there certainly is a need to educate consumers in general, including of course superannuation fund members, but I think that this is something that will happen. I feel there is a growing sophistication in people in general in financial matters. I mean, they're becoming increasingly conscious of the fact that they've got to think about their retirement, they've got to think about saving something, that they - if you look at the newspapers, the increase in money columns, money liftouts, television programs - I mean, I think there is a movement in this direction and I'm optimistic that it will continue and that fund members will be able to make intelligent decisions about what is going to be a very substantial investment over time.

MR COSGROVE: Yes, I think most of that growing interest is a function of the increasing wealth of the Australian community. I think as communities acquire more financial assets in particular they tend to think about how well they're being invested, whereas if you're playing peanuts, you know, it's no big issue.

MR ROFE: And who has a better incentive to look after your money than you yourself?

MR COSGROVE: Indeed. I guess another question that arises with respect to accountability at public meetings of the kind you favour is how many of the members would take an interest and that again is hard to know. As you pointed out in your analysis of the membership figures at the beginning there are a large number of superannuation fund members who still don't have a very large stake in the business and in fact most of the big balances are in the DIY sector it seems so, yes, it's an interesting question.

MR ROFE: I mean, realistically, if you take a typical public company meeting only a small percentage of the total shareholders turn up at the meeting, an increasing number vote by proxy and we hope before too long a large number will be able to avail themselves of electronic voting facilities. So with that, with things like Web broadcasting of meetings I think there's an increasing scope for intelligent participation by either shareholders or fund members in meetings.

MR COSGROVE: Yes. The short-term investment focus, for us is any issue in that area would seem to rest on the question of whether or not the legislation itself requires - I don't think it does require such an approach, or whether it somehow induces such an approach on the part of trustees and/or their investment managers. You may not be any more familiar with the system than we are, I guess.

MR ROFE: No, I'm not aware of any particular provisions and, as I say, I don't profess to any expertise in the SIS legislation. I'm not aware of any particular provisions which are likely to affect this. I certainly wouldn't like to see prescription of - I mean, I'm old enough to remember things like the 30-20 rule and so forth.

MR COSGROVE: So are we.

MR ROFE: I wouldn't suggest we go back to that type of regime.

MR COSGROVE: No.

MR ROFE: I think the most one could expect of legislation is certainly not to restrict but to facilitate and possibly encourage a longer-term investment horizon.

MR COSGROVE: I think I'm right, Roger, that the SIS Act does encourage diversification of investments.

MR FRENEY: Certainly. I mean, it basically proposes a prudent person approach to ask trustees to manage the money as if it were their own and then it has a number of layers. It may be one that might incline towards short-termism, that is, a requirement to have sufficient liquidity to meet your shorter-term requirements which is completely understandable. I think perhaps one line of argument, Ted, is that a prudent person sort of approach might suggest a touch of conservatism that - you know, and so there has been a little bit of discussion about that as to whether within superannuation funds there's a slightly more conservative approach taken to portfolio balance.

MR ROFE: I think there possibly is, and I suppose when you use the word "trustee" I suppose it sort of tends to put in people's mind a bit of, as it were, a conservative or prudent approach. I think Kohler does raise this point about the confusion between volatility and risk on the one hand, and I think the point you made about investment policies and diversification, again I think that I suppose portfolio theory would indicate that risk can be minimised by appropriate diversification. I guess that's perhaps another reason for arguing that the well-intentioned amateur isn't necessarily the best person to put in charge of the fund because they may not perhaps appreciate some of the principles behind a long-term investment strategy.

MR COSGROVE: The other point I was going to ask you about was your allocation of activities, functional activities if you like, across different pieces of legislation. I mean, it's something that we've given a little thought to ourselves. We've heard today though from several people that they're already worried that too much of that kind has happened - you know, that the package, the integrated package of legislation under the SIS Act as originally put in place is now fragmenting across FSR Bills and tax legislation and statistical collections and so on. Conceptually, the sort of allocation you were advocating has some appeal but as a practical matter it might produce some problems for compliance and - - -

MR ROFE: I don't know, I think it's something that has to be faced. I mean, if you could say that superannuation was a completely separate area you could have a single act, a SIS Act, to regulate all aspects of that particular activity. But the fact is that because of this convergence which is taking place, that the same person, the same company, is providing managed investments and superannuation products. You can't just carve it up like that and, as one of the speakers said earlier, a number of financial service providers are voluntarily adopting the MIA approach.

MR COSGROVE: The Institute of Chartered Accountants, yes.

MR ROFE: I must say that my contact and experience is greater with ASIC than with APRA but certainly my impression over the last year or two is that ASIC has been operating pretty effectively in its, I suppose you would say supervisory role, under MIA. It seems to have a fairly output or results-oriented approach to regulation, and certainly from my contact with ASIC and with people in the auditing and compliance area, it seems to be working pretty well and I feel it could work well for the superannuation area too. So I'd have, as I say, what I might call the honesty, integrity and accountability under the Corporations Law and a sort of a second layer that relates specifically to the features of superannuation which are distinct from simple managed investments like this, sort of, general incomes retirement policy and - - -

MR COSGROVE: Yes, preservation et cetera.

MR ROFE: - - - and prudential regulation as being the principal function of the SIS Act and of APRA.

MR FRENEY: Yes, you seem to be able to - I think we all agree with the ultimate objectives of both protecting the balances of superannuation fund members and trying to maximise the long-term compounding growth of those balances and prudently managing all that. That's the main aim of SIS, to get this prudent management but how you divide it up into the most efficient legislative framework that most cost effectively meets that end objective is quite a nice challenge, and I can empathise with what you're saying. I'm just wondering about how it would apply to company superannuation funds. I can see it particularly with respect to the large institutional funds managers. I'd need to think a bit more about it as to whether you could plant that onto the 2000 - or whatever it is - 1000-odd corporate superannuation funds that we still have in existence. It may work - - -

MR ROFE: Yes, I wonder how much of the activities there are outsourced.

MR FRENEY: Well, quite a lot - - -

MR ROFE: I would think an increasing proportion, yes.

MR FRENEY: Which actually led to a question that I wondered whether you might have a handle on. When you're thinking about efficiency of all these systems, the sort of total resources that are deployed to managing superannuation and when you think of the trustee framework and that sort of outsourcing that you were just mentioning, does your association, sort of, have any feeling for the totality of resources and whether it's appropriate - - -

MR ROFE: No, no, we don't, and I think there was a difference of opinion between Michaela and Phillipa Smith about the cost there. So, I mean, if they don't know, I wouldn't put my hand up there.

MR COSGROVE: Thank you. Any other points for review that occur to you?

MR FRENEY: No, well, I just want to get right in my mind this question of the convergence and your model was one of thinking of still having - I mean, you have the Corporations Law, MIA together and FSR, and as you were saying, they would deal with the accountability, integrity and honesty, sort of, angles.

MR ROFE: Yes.

MR FRENEY: But then you would still have a Superannuation Prudent Management Act that would deal with the superannuation peculiar parts of that financial package.

MR ROFE: Yes.

MR FRENEY: I'll need to think more about it because those elements of accountability, integrity and honesty, you could say, are very germane to prudent management.

MR ROFE: Yes, but - - -

MR FRENEY: So that would sort of uncouple them and have them legislated for in two different acts. I'm just wondering how that's going to work.

MR ROFE: No, I think you can - I mean, I think the idea of prudent management isn't just restricted to superannuation. I think - - -

MR FRENEY: No.

MR ROFE: - - - you know, anyone that's dealing with other people's money should handle it prudently, whether it's superannuation or managed investments or what have you. So I think you can identify, you know, some basic issues involved there: honesty, integrity, conflicts of interest and so forth - - -

MR FRENEY: I'm not denying that they shouldn't be identified, I was just wondering whether it's more cost effective to have those dealt with under the Corps Law and MIA and FSR et cetera, or from the point of view if you are a trustee of a superannuation fund - coming back to the old point that some of the proponents were making this morning - should you have it all within the one legislative framework?

MR ROFE: Well, as I say, the other thing is the practical situation that at least some of the providers here do provide both superannuation products and other products, and insofar as they're providing other products, they can't avoid being under MIA - - -

MR FRENEY: Sure.

MR ROFE: - - - and from their point of view, if they can have one regulator dealing with that and leave the specialist overlay to a separate group that has expertise in this separate area, I suspect that it would be more efficient and cost effective.

MR FRENEY: Thank you very much indeed.

MR ROFE: Thank you.

MR COSGROVE: Yes, thanks Ted. We look forward to receiving your submission.

MR ROFE: Okay.

MR COSGROVE: Thank you.

MR COSGROVE: Our next participant is Phillips Fox, Actuaries and Consultants. Gentlemen, for the purposes of our transcript, would you each identify yourselves and the capacity in which you're appearing today, please.

MR RICE: Yes, my name is Michael Rice. I'm an actuary. I work for Phillips Fox, Actuaries and Consultants.

MR CHARTERIS: I'm Peter Charteris. I'm the superannuation partner in the Sydney office of Phillips Fox.

MR COSGROVE: Thank you. I see you've brought along with you a submission, which is very good of you but obviously we haven't had a chance to read it. So perhaps you could tell us what you have in mind.

MR RICE: Okay. We only have a few brief issues to raise. We think generally that superannuation in Australia is pretty well managed and regulated. The incidences of members losing money through fraud or negligence are actually quite small relatively. However there have been a few recent occurrences, such as the Commercial Nominees fiasco, and we think, given the age of SIS in a fast-moving world, there are probably some areas that could be changed to enhance member security and possibly cut costs. So if we could talk to some of those.

MR COSGROVE: Sure.

MR RICE: The first topic we'd like to raise is whether the role of trustees is still appropriate as a mechanism for managing superannuation benefits. For example, in the banking industry there's no such thing as a trustee. Members' money is held quite well in security. In our opinion, we feel that there is a significant difference between non-profit funds where the trustee has a fiduciary role primarily to look after members' interest. In fact their prime purpose is to maximise their retirement returns. However the many public offer funds, particularly those run by financial institutions, the prime motive is profit for the institution involved - superannuation is a business - and in those cases we wonder whether the imposition of a trustee just creates another layer of cost.

If the financial institution has to set up a board of trustees, the people concerned are often executives of the life company or the bank or whatever, and clearly they have a conflict of interests. On the one hand they have to look after members but they've been appointed by their institution to help run this business, and we're not sure if there's any added value in that arrangement. There is a precedent - perhaps not a good one - but the retirement savings account issued by banks doesn't have a trustee.

MR COSGROVE: All right. So that's it?

MR CHARTERIS: Yes. I think, to my mind as a lawyer, the distinguishing characteristic is whether or not there's member representation. The industry funds, the corporate funds, you have equal employer-employee representation. I think the trustee role is essential there given the nature of that sort of fund but when you move into the master trust run by the financial institutions, there's no member representation, there's no employer representation, and you have to wonder about the role of trusteeship there when it's run by a large institution without representation.

I think the final point on that particular part of the submission is, you do have policy committees for funds where there's not equal employer-employee representation but they really are largely ignored in the sense that there's no interest at the member level. They're seen to be a burden by the institution and they don't have any real power anyway, so you'd have to question the role of a policy committee.

MR RICE: It does mean though that in those cases quite often members have no real representation. If an employer and an institution are not particularly interested in policy committees, they take up the time of an employer and they cost money for the institution, very often they don't exist. They just wither and die, and in those cases technically the member has no representation other than these employees of the financial institution acting as trustee. So its debatable whether the current format of the policy committee is working. Possibly that needs to be revamped in some way.

MR FRENEY: Would you like us to ask questions as we're going - - -

MR RICE: Sure.

MR FRENEY: - - - or would you like us to cycle back to - - -

MR CHARTERIS: Well, if questions occur here, yes.

MR FRENEY: Is that okay?

MR RICE: Yes.

MR FRENEY: I don't mean to interrupt your presentation if you prefer to go straight through it.

MR RICE: No, it's quite okay.

MR FRENEY: I was just wondering. In these for profit organisations, if you took away the concept of a trust and a trust structure, what would remain as the protection for the members of the superannuation fund? Can you liken it directly to the MIA - if you took away the trust's requirement for a super fund, can you liken it directly to the Managed Investment Act requirements where - you still do have the concept of a trust - - -

MR CHARTERIS: You still do, yes.

MR FRENEY: - - - as I understand it.

MR CHARTERIS: Life insurance would be a better - - -

MR FRENEY: So, in a sense, what would be your replacement model for not having a trust structure?

MR CHARTERIS: Well, the life insurance industry outside superannuation and managed investments historically has been purely a contractual relationship. There's been quite detailed regulation as to the maintenance of statutory funds and those sort of things. You'd basically have a contracted relationship. You would obviously need to make sure you have a proper level of disclosure so that people know exactly what it is that they're purchasing, and you need a prudential regulation. I think if you were to provide for the option of not having a trusteeship, one would look closely at, you know, the regulation of life companies because there's a long history of investment products without trusteeship. It's purely a contract, clearly with a prudential overlay, statutory funds, and all that sort of thing.

MR RICE: It's also worth saying that in many cases the members and the trustees never meet. The employer might meet a representative of a financial institution and sign a contract of some sort to put money into the master trust, say, of the financial institution and set the benefit design, including the levels of insurance and perhaps the default investment strategy. Members need not and often don't have any say in that. So the trustee-member relationship is not a very close one.

MR FRENEY: Perhaps if Peter could help me a little bit further. It's an interesting point, this one, about the protection for the members which is really what SIS is all about, prudent management protection. Under contract law, my understanding is that there may be some weaknesses of contract law in terms of protecting the interests of members versus the protection they get under the trust law. For example, I think, given the very long-term nature of superannuation, that a party to a contract can probably terminate it relatively easily - and I'm not sure whether they can terminate it quite as readily under trust law - but am I right? Are there differences in terms of the protection of member interest under contract law versus trust law?

MR CHARTERIS: There are certainly different rights. Whether at the practical level it results in a significant difference I'm not so sure in the context where you don't have any balancing of the interest, which I think - I see a big difference between the industry and corporate funds where you have representation from the employers and employees, which I think works very well because you have a balancing of the interests but once you come to the institutional type product there's no balancing of the interest. I mean, the entire representation on the trustee is the institution. There's no other representation. I think in practice it's hard to see that, yes, there are differences as to duties and all the rest but you'd have to wonder at the practical level whether there's any difference when you could deal with the matter of contract. I mean, some of the largest pension funds in the world where there's mandated pensions involved - with the Dutch pension fund, I mean, it's all in contract there, as I understand it. I do a little bit of work for some Dutch pension funds and obviously something can get lot in the translation but, as I understand it, you do have these special purpose vehicles that have special legislation under Dutch law but the basic relationship between the pension fund and the member, as I understand it, is in contract and it clearly - obviously they don't have the concept of trust so wouldn't consider that as an alternative, but to my mind there's no reason why it can't work. At the end of the day I would see it as an option if the institution decided do they want to go through this at a level of expense which I think at the practical level achieves very little when you don't have a balancing of the interests, or just go into a straight contract really which, commercially speaking, I think is how it's viewed: you're promising a certain outcome for a certain fee. I mean, that's the bottom line as I see it in institutional superannuation.

MR FRENEY: So that would be akin to buying a life insurance product from now on?

MR CHARTERIS: That could be used as a model, although I suppose one might say the old endowment products didn't work very well but I think there are other reasons for that. Moneys were used to promote other business rather than sort of promote the outcome under that product and you'd argue that some of the taxation treatment no doubt affected the outcome as well; you know, the grounds for distinction. One of the things I was going to mention at the last point, there is under SIS no statutory right to transfer between funds but I think that would be an issue for contract as well as trust or - people need a statutory right, I think, to bring that relationship to an end and to start another relationship. I mean, it's a question of how long it should be - I was involved in the setting of some of the RSA legislation with the then ISC and one of the things that I was very concerned about is that people have a right to bring the contract to an end under the RSA legislation, which hasn't worked for other reasons. If there is a statutory right the institution must allow you to bring that contract to an end no later than 12 months after you give notice. There's no equivalent in SIS.

Most reputable funds of course allow transfer on a much shorter notice period but it is, I think, a defect of SIS that there is no statutory entitlement to that. There are in fact still a few trust around where you don't have a right - I'm pleased to say that people are recognising it's not very appropriate but there's nothing stopping a trustee that's minded not to let you go to not let you go. I think as a matter of consumer choice you must have a right - to my mind, the issue of what's appropriate for notice, you can't have runs on funds. You could make a debate where funds that have got long-term strategies become unstable if everybody can give a short-term notice - I think there are issues there - but the basic principle must be that with appropriate notice you should have the right to move your money.

MR RICE: Just finally on trustees, I had better make a point too.

MR COSGROVE: Yes, certainly.

MR RICE: Not all public offer funds are run by financial institutions. There are groups such as accountants, actuaries, financial planners; they don't have a capital base of financial strength so they really fall in the middle where they are a with profit fund but they're not backed by a strong institution regulated by APRA.

MR COSGROVE: So the implication of what you are suggesting would be that the not for profit funds stayed under the SIS Act?

MR CHARTERIS: I think you need the one regime applying to everybody. What I think you want is probably a greater range of options as to the type of product that may be offered. I mean, there are other things in SIS about cashing of benefits and all these sorts of things. SIS goes from when you have a few sections dealing with trustee duties and various other things; you've got a whole complaints regime - you would hardly change that. You've got restrictions on payment; you wouldn't change that. You have various accounting obligations; I would imagine there would be no reason to change those. So it's really - - -

MR COSGROVE: I thought you were saying that the for profit funds would fit most efficiently under a managed investment trust structure.

MR CHARTERIS: Managed investments are also a trust structure and I think the comments I make in respect to superannuation are probably equally applicable for managed investments. I mean, it's what does the trusteeship relationship actually achieve that couldn't be achieved by a contract. But SIS is much wider than that. I mean - - -

MR COSGROVE: I see, I think I'm with you. You would make allowance within SIS for contract arrangements.

MR CHARTERIS: Yes, because you'd have the options of a trust investment or a contract investment, but a trusteeship is, to my mind, only one element of SIS. There's the whole retirement incomes policy component, you've got prudential requirements, reporting requirements. There's a number of issues that SIS deals with. It would be a lot shorter if it only dealt with trusteeship.

MR COSGROVE: I wonder, thinking from the point of view of the larger financial institutions' point of view, would they find that very satisfactory? The would still need to comply with the Managed Investments Act in their general investment funds work, and then they would have to pick up compliance for their superannuation funds under the SIS Act.

MR CHARTERIS: I see the issue is to offer the option for those who can see a cost advantage in it. I don't think it would be compulsory and it may ultimately turn out to be more theoretical than real.

MR COSGROVE: Yes.

MR CHARTERIS: We do have some other issues, I think - - -

MR FRENEY: Perhaps Michael has raised the interesting point too, like there are different kinds of public offer funds or for profit funds that you'd have to think carefully about if you went into a contract option within SIS, whether that would be open all who might want to avail themselves of it or whether you would need other protections; I'm not sure. I don't know what protections the contract law gives to members of superannuation funds.

MR CHARTERIS: There would be an issue about, I guess, asset backing which hasn't I think really been an issue. I mean, industry funds have no capital and it certainly hasn't been a problem. There has been one exception, which quite frankly capital would have made no difference. I mean, for some reason the board went berserk which is most unusual when you have that sort of balance of representation. Certainly in my experience of attending - having been involved in industry funds for a number of years now it's a balance that has worked very well to date.

MR COSGROVE: Okay, thank you.

MR CHARTERIS: SIS has a number of particular false and misleading type provisions that used to appear in the Trade Practices Act and now appear in the ASIC Act. I think as a technical point there's no reason to have false and misleading provisions appearing in more than one act applying to the same person because the wording is never exactly the same. Simply from an efficiency point of view I think current policy is that the ASIC Act applied generally speaking to financial products other than shares et cetera because they've gone back into Corporations Law itself. There's no reason to have the ASIC Act applying to superannuation in the false and misleading provisions and at the same time have its own false and misleading provisions in the SIS Act. I have not been able to find out why, but I do know as a fact from a live matter that the regulator certainly prefers the ASIC provisions over the SIS provisions even though the SIS provisions have a six-year statute of limitations and the ASIC provisions have a three-year statute of limitations. I could not quite work out why that was so when they clearly had power under both. It's just duplication, is my point on that. I should add there's a move afoot to amend the Trade Practices' false and misleading to six years and I assume that's following in the ASIC legislation road. It's impossible to keep up to date with every proposal of change.

MR RICE: We move on to an investment strategies. There are a number of points on this. APRA has grappled with the issue of what investment strategies to allow various funds and they have been inconsistent in some areas which we'll come into. One of the problems we see is that there is no true to label brand in the market, so that you can buy a product that, for example, says it's balanced and that can mean different things to different people. Now, the investment markets are reasonably sophisticated and their communications material is pretty good and anybody that follows it closely will be able to find out what sort of product they're going into. But there have been cases - the one we raised earlier with Commercial Nominees where they had an enhanced cash fund that was invested in mushroom farms which were illiquid and in fact non-performing.

It seems to me that there should be something in the regulation that would protect members from investigating in what appears to be a cash fund, where they're seeking capital security, and then ultimately find out that there are significant capital losses in that fund because of the directors following a particular strategy. APRA is quite conscious about allowing members to direct investments so in fact in many master trusts they've forced the promoters to withdraw certain types of assets - for example, share portfolios - and forced them into a managed investment class where the investment manager in fact makes the particular stock selections. I don't particularly have a view on whether that's good or bad other than that there seems to be some inconsistency. If you take some large industry funds, including the ARF, allow their members to buy Coles-Myer shares primarily to get a discount on purchases, it seems a bit incongruous that somebody with $3000 can spend all their money on Coles-Myer shares where someone in a master trust with $300,000 can't make that decision. So just perhaps some - whether it's in the regulations, some tightening of that. I also think that APRA's rigidness on that policy has itself forced a lot of people with large accounts out of big funds and into setting up their own funds where they have more flexibility and that seems to be an artificial device to - you know, it obviously costs a lot more money to run your own fund. It seems incongruous that you can't get most of what you want for the same price in an existing arrangement.

MR COSGROVE: But that's not affected by the increasing incidence of choice of investment within superannuation funds?

MR RICE: The typical master trust will have a wide range of asset classes and fund managers but when it gets down to individual share portfolios they're deemed to be member-directed investments and many master trusts are not allowed to offer those as an option, and that's a directive of APRA. If we just complete comment on investment strategies, when an employer selects a fund they have to pick a default investment strategy. There's a tendency to pick fairly conservative strategies because members get annual statements which are in a bank account form if it's an accumulation fund and one of the difficulties is that human nature seems to be that people will get much more upset about loss of capital than loss of potential income forgone. So there's a tendency - although superannuation is allegedly long term, we have too great a focus on these annual statements and how well people have done in the last year. This leads into all sorts of strange behaviour. People will pick a capital secure default option that might only have 30 per cent exposure to growth assets because they're trying to minimise annual capital losses but they also may be minimising the long-term return for those members.

We still have an environment where the majority of members are uneducated, ill-informed about superannuation, partly because of the complexity of the situation, and so they trust that what the employer has set up for them is correct, and so there's very little movement from those people outside those default investment strategies.

MR COSGROVE: But without prescription of a sort of a minimum growth component in a default strategy what can you do to change that sort of behaviour?

MR RICE: If evidence suggests that growth assets out perform over the long run and people can't get their money for many years possibly - - -

MR COSGROVE: A case for prescription.

MR RICE: Particularly if members don't have to stay there.

MR CHARTERIS: One of the provisions in SIS which I think is an essential provision and there are some serious constitutional problems, is the ability to enable funds to have an orderly wind-up, because not all funds are economic. It would be unsatisfactory if the trustees couldn't wind them up and transfer to other funds because you'd simply dissipate the assets. It is not at all practical in any large fund to obtain the consent of all the members and accordingly there is the successor fund provisions which, provided you've got power under trust law to do and there's a debate about that amongst my colleagues, you can transfer to another fund. There are some problems with the current regime. There is a genuine debate as to whether you satisfy the current definition as to what is required, because it requires that there be equivalent rights. There can be inordinate debates on that. The other problem - - -

MR COSGROVE: Sorry to interrupt. Does this revolve around things like the carryover of death benefits as distinct from the financial asset in the fund itself?

MR CHARTERIS: Both trustees have to be satisfied that there are equivalent benefits under the current regime and there is genuine debate as to what that might mean. APRA have issued some guidelines which to some extent focus on defined benefit funds. One of the problems is that it can be a very slow and expensive process because there's no real brake mechanism. In the case of corporate funds who want to wind up it's perhaps not a problem because they're usually keen to get on with the job, but what can happen in the context of a master trust in effect if employers decide that they really don't think this master trust is working, usually in consultations with some of the employees they think that everybody would be better off in another fund and they decide that they're going to stop contributing to that fund and switch to another fund and if the trustee of the outgoing master trust doesn't want to cooperate they can basically bring the process to a grinding great halt, knowing full well that they'll never get the consent of everybody.

So under the current regime there are difficulties as to what it means, it can be easily frustrated if the outgoing trustee doesn't want to cooperate. One of the - and again there's debate on this one - one of the suggestions is that there ought to be greater scope to effectively delegate to the actuaries if they certify to the effect of this thing rather than trying to get the lawyers on each side involved and agreeing. It's an area that does need, I think, further consideration because it's not I think working as efficiently as it could.

MR RICE: It should be noted that people tend to look at equivalent rights one by one, so even if a fund is significantly better in almost all aspects but if there's one where it's slightly worse then it doesn't comply - and yet it's interesting to know what is deemed to be equivalent and what isn't. For example, you must have at least the same sum insured for a death benefit but you could double the premiums and that would be all right. There have been issues where people have nominated beneficiaries in one fund and not in another and so they've argued that potentially those beneficiaries may be worse off; they may not receive the benefit. We've had one case where a trustee stopped a transfer on that ground.

MR FRENEY: The intention is understandable and sort of laudable in terms of seeking to protect member interests; the difficulty is to get the detail of either the regulations or the guidelines as clear and as straightforward as possible.

MR CHARTERIS: There's a balance of interests required. I mean, it's essential that members' interests are protected because the very nature of a successful fund transfer is they're not consulted before and obviously you clearly can't have an arrangement where they suddenly end up worse off. The problem with the current arrangement is that it's a process that can be easily frustrated by people who have other interests and wish to frustrate it for that reason. There's no real brake mechanism and there is genuine disagreement. I mean, people are concerned that what's being proposed doesn't satisfy them. We have one side saying, yes, it does, the other side saying no, it doesn't - often over relatively fine differences. If there's a major difference it's usually self-evident that it doesn't comply and it's only the poorly advised that think otherwise. To put it another way, I think the current arrangements go part of the way in achieving what's required but I think they are unnecessarily expensive and complex in their day-to-day implementation.

MR RICE: Another issue for some employers is that the trustee of the fund that's losing the business if it's from, say, one master trust to another, will say that the onus is on the employer to pay for a lawyer that will satisfy them. So the employer can incur costs at the whim of a trustee and that also adds to some aggravation in the process.

MR CHARTERIS: Enforceability of contributions I think is a real issue. I think there's a fundamental misunderstanding in the community about what trustees' rights are in this area. Paragraph 3.14 of the Senate Select Committee on Superannuation and Financial Services Report referred to a press report concerning the TWU Superannuation Fund. If you go to that press report there was a fundamentally erroneous assumption and that was that a trustee of a fund has a right to enforce contributions. Now, that is often in fact not the case. If you look at superannuation guarantee it is a voluntary payment by an employer to satisfy a tax obligation. Without more, a trustee has no right whatsoever to take any enforcement procedures at all. Award obligations are an arrangement between an employer and employee. Again, a trustee has absolutely no right whatsoever, no standing, to take any actin.

The only way a trustee can obtain a right is to obtain a deed from an employer whereby they agree under that deed that they will make contributions to the fund. Some employers do that, some don't. As a matter of employment law an employer has no obligation whatsoever to sign such a deed and I don't believe any trustee could ever force them to do that because if they have an obligation to pay into an award fund it is beyond the employment relationship. If they tender their money the trustee cannot refuse the money and they have no rights other than to record what they've received and report to the members - perhaps report to the members, "Well, we think maybe something more should be coming in, we don't know; we're not a party to the arrangement. Maybe you should be speaking to your employer." This I think is a fundamental misunderstanding in the community that the trustee has a greater right than this.

The effect of that is a huge void in the system because you have contributions coming in to somebody who has no rights really to do anything about them unless - and certainly many employers do, I should add, agree contractually to pay amounts but they don't have to and often they don't, and even those who agree, they'll sell their business to someone else and they will never sign a deed. The trustee will have no idea the business has changed because the contributions keep coming in until there's a financial problem or some other problem and suddenly they stop. They then look at what they should do. They send out reminder notices. Most reputable trustees do have credit collection agencies but at the end of the day if the employer folds their arms and says, "I'm not going to pay," they have no right to sue them. So this, I think, is a fundamental defect in the whole system, is the inability to enforce obligations, and I think there's a fundamental misunderstanding in the community that trustees automatically have a right to enforce when in fact you have to track through a number of steps to determine whether or not they have a right and, yes, sometimes they do have a right but not infrequently with the problem cases, and the problem cases that get reported in the press, in fact they have no rights whatsoever. This is an area that I think is seriously remiss.

There are obviously some constitutional issues here from a point of view of Commonwealth reform because the Commonwealth doesn't control debtor-creditor law for starters. I think ultimately - I suppose my personal view is that you probably need to look to ESG-type arrangements, either by modification which you probably could do although the attorney-general may not agree with it - you could perhaps require that you nominate a fund and you agree to pay to a fund as well as the actual obligation. You may be able to finesse the mechanism; that would be one possibility. Certainly if you shorten the ESG time frame there would be at least a tax obligation that arose more frequently and so there would be an incentive, but again there would be no legal obligation on the part of the employer to pay more frequently and you may deal with it that way. But it is an area - in fact, I think it is one of the areas that is a real problem. The reports to the parliament of the Senate Select Committee I suspect understate the problem because there's certainly a lot of employer insolvency and because these are amounts that are not paid directly to the employee the employee is not in a position to immediately realise that there's a problem. It takes time for trustees - yes, they may have follow-up procedures but there's a much bigger time lag and ultimately at the end of the day there's nothing they can do anyway. So I think it is an area that is seriously - - -

MR COSGROVE: Would you propose then, Peter, that the SIS be amended to provide trustees with the power to enforce contributions?

MR CHARTERIS: I don't see how you can in the sense that the SIS to be constitutionally valid, as has been determined in the High Court in Breckler's case, says that a trustee can make an election to be bound by this system. I don't see how you could force an employer to do that. On what basis can you force an - you can't force somebody to do a voluntary act - that's what it would require; whereas the trustee is undertaking a voluntary act to be bound by that system. The employer has nothing but obligations. I fail to see how you could force an employer to voluntarily do something. It has to be by some other mechanism. I mean, I suppose the other thing, if award superannuation - and I suspect there's a constitutional issue; probably the Commonwealth cannot give a trustee standing to take action under an award because it's not binding to the employer-employee relationship. I mean, that would be I suspect a question that may well keep constitutional lawyers occupied for many hours because there have certainly been some comments by the High Court in the bread manufacturers' case that superannuation is part of the employment relationship but I think once you get to the trustee it's not, and just where the boundaries are drawn is a question mark.

The fundamental thing I think that people forget is the employer is not a voluntary participant in the superannuation regime; the trustee is, and other people. But employers are just meeting obligations of a statutory award or individually contracted obligations. They don't make any elections to become part of this. They may choose to make a contribution to not have an ESG obligation but under the current system design that's really outside of awards; it's the extent of their compulsion.

MR FRENEY: I thought at a glance that the SIS provides that if an employee authorises deduction of super payments - - -

MR CHARTERIS: Section 64.

MR FRENEY: Section 64 - then section 64 puts the onus on the employer to make the payment within a certain period of time.

MR CHARTERIS: That's right. The trustee - - -

MR FRENEY: Like within 28 days.

MR CHARTERIS: First of all, I fail to see how it could possibly be constitutionally valid on any analysis.

MR COSGROVE: I wouldn't engage in a discussion with you about that, Peter, but - - -

MR CHARTERIS: I just can't see how. If you look at Breckler's case it requires a voluntary act. Where's the voluntary act? If it is enforceable it only applies to employee voluntary contributions; it doesn't apply to employer contributions. I assume the parliamentary draftsmen must have thought long and carefully about it before they drafted it, otherwise you'd have it applying to the whole lot, so that - I'm not aware of what the reason is but there must be a reason for that. Presumably the draftsmen at least thought that if you had it for employee contributions it would stand up constitutionally.

MR FRENEY: I thought for our purposes the sort of issue was one of the - not necessarily the trustee being able to enforce contributions being made but checking up as to whether contributions have been made and then the question for us sort of comes down to one of the relative efficiency and cost effectiveness of whether it's a reasonable thing to ask a trustee to do, and we've had various comments about that, or whether there's a better way of doing it - all this in the interests of the members; you know, what's the most cost-effective way for the members - - -

MR CHARTERIS: Perhaps I need to make it clear. I see the issue as a right to take action. I mean, no trustee should spend good money when it's quite clear - so assuming under the current regime the employer signed a deed of adherence you've clearly got an enforceable right. Under no circumstances should a trustee spend good money chasing an insolvent employer. That would be just a waste of money and no trustee has a duty to do so. A trustee has a duty to take reasonable steps to enforce. The point I was trying to make is they have very little rights upon which they can actually take those steps. Yes, you can monitor the contributions, you can write saying, "Why haven't you paid," you can certainly inform the employees, but there are people who are solvent who just pay once a year because they say they've only got an ESG obligation. You can't make them pay more frequently than that unless they've signed a deed of adherence, so you can't take action to get more prompt payment. That has a cost to the member. I mean, I guess that becomes a policy issue: while they're meeting their ESG obligations the clear policy is you only get it once a year; therefore you don't get the earnings for that year. But it would be rare that a trustee would have a contractual entitlement to do anything about speeding that process up, in other words to make it regular monthly, which for example most awards provide for regular monthly payment and a trustee can do nothing about an award that says, "You will pay monthly." They have no standing to take action under an award

MR COSGROVE: All right, okay. That's interesting.

MR RICE: The final point on disclosure is an interesting one and again it perhaps comes back to overlapping legislation. The proposed FSR Act will have significant disclosure which apparently will be valid over all funds, not just public offer funds. That needs to be looked at very carefully. I know submissions to ASIC are currently being made on the bill but there are, even now, some areas where the disclosure is going to be impractical. Peter has got an example of one.

MR COSGROVE: Yes. Something like a third of industry fund members are enrolled without any documentation whatsoever and a significant percentage of these members are not interested in providing any documentation until the time comes for payment, and I think the system has worked quite well, notwithstanding those limitations. These people are given a basic level of the trust cover, sometimes even before - it depends on the individual contracts - but sometimes even before they nominally join the fund; just so long as you can track back to a reliable employer and you can show an employment date. Because I've certainly had cases where people have been killed on the first day of employment. They were eligible for the cover and the estate gets paid the benefit even though the form hadn't come through and been processed.

One of the concerns I have with the FSR Bill at the moment - and I'll be taking this up elsewhere - is that there's now this concept that you must be given documentation within three months of joining whereas before it was the reasonable efforts - and that means you cannot comply for the average industry fund in a significant number of cases. Now, what is the alternative? You've got to get rid of those people within three months or you're committing a criminal offence for which you can go to jail for, which means you'll have to stick these people in (indistinct) where there are none of these benefits. In other words, if there isn't further work in this area, there's going to be a significant loss of benefits because, human nature being what it is, because it's compulsory, people are not really interested and you can't make them interested because they're not doing it by choice.

I am concerned that there's a move to require a greater obligation to hand people documents that aren't actually achieving anything. Because people have to enter the system - certainly the documents seem to be there - if they want them, and I don't think there's any question about that, but they're not actually interested in receiving them and to sort of make it a criminal offence if you don't give them within three months rather making reasonable efforts - "reasonable efforts" means if you've got no detail you don't have to do anything - that it is upping the disclosure requirements and having an effect of reducing the benefits that are being offered as a result of that. In other words, the paper is driving a reduction in benefits and that is an area that I suspect the bill may well get amended on that front.

But it's an area that does cause me concern; that the concern about disclosure - the growing policy is not taking account of what's actually happening and it's important that the sort of low-cost entry environment is not destroyed in the desire that everybody have all the information that the regulator thinks they need, and the reality is a lot of them are not interested. Yes, it should be available but it shouldn't be a pre-condition or a condition that applies shortly after joining that would cause a loss of benefit, which is what the current policy is heading towards. And plus there's the cost. I mean, you've got to cover all these procedures. You can't just kick somebody out of your fund without going through a procedure, and so that has a cost.

But unless human nature changes, you know, you'll have to go through this procedure so you've acted properly or without achieving anything because you never had a chance other than the theoretical chance of actually getting the information in the time frame.

MR FRENEY: And you did say, Peter, that the absence of documentation, if a joining member didn't want to have it, that wouldn't jeopardise their entitlements - - -

MR CHARTERIS: It doesn't under the current regime.

MR FRENEY: No, under the currently - yes.

MR CHARTERIS: And - - -

MR FRENEY: And so long as you go through the best endeavours to provide within three months.

MR CHARTERIS: We'd have to take reasonable steps.

MR FRENEY: Reasonable steps, yes.

MR CHARTERIS: Well, if you don't know their whereabouts you don't have to do a lot to satisfy the requirements. It's not a high standard. Reasonable steps where you don't know their whereabouts is not a high standard but the current proposal is that there's an absolute requirement that they receive it within three months. When you don't know somebody's whereabouts, that means you have to remove them from your fund within three months or you're committing a criminal offence, which means you must remove them. To satisfy your trustee obligations, it's my view you'd then have to undertake an inquiry process before you can remove them because you're taking away a benefit which the law requires you to take away. There's no question the law says, "You must take away those benefits or you go do jail." I don't regard it as a very satisfactory approach. In fact it's completely unsatisfactory. I think it's important to recognise that people don't fill out documents. I think it's something that the regulator is having trouble coming to grips with. People don't fill out documents.

MR FRENEY: Anything else?

MR COSGROVE: No, unless there was any other, sort of, general topics that Michael and Peter wanted to address. Okay. Well, thanks for some thought-provoking ideas in your paper which we'll have a closer look at with a little more time. Thanks for coming along.

Our final participant for today, I think, is Mr McAuley. Please come forward. Mr McAuley, I take it you're appearing in a private capacity today. Is that the case?

MR McAULEY: That's right, yes.

MR COSGROVE: Thank you for the submission you've given to us.

MR McAULEY: Shall we start?

MR COSGROVE: Yes.

MR McAULEY: Good.

MR COSGROVE: Please.

MR McAULEY: Well, at this time of the year it's getting close to 30 June. We've got millions of Australians doing what I'm doing; that is, working out what we're going to do about superannuation before 30 June.

MR COSGROVE: Oh, yes.

MR McAULEY: If you're an employer, of course you're keen to make the payment before 30 June so you get the tax deduction. If you're a self-employed person, much the same thing. If you're an employee, well, you're always glad to have anything for nothing but any one of those three categories would well look back to what happened with their investment a year ago and perhaps that might influence their decision this year. So supposing the employee or employer or self-employed person put in $1000 last year, this time last year, then he'd have to do his sums to find out what its value is at the present time. That's a very pertinent and reasonable thing to do. If he did that I think he'd be rather amazed to find what its present value is. If however he had $1000 a year ago and he put it into this very delicious savings in an investment account, that $1000 would have earned an interest of about $10 - not a handsome sum. In fact, it's about .1 per cent. That's all they pay and you get charged $3 for a withdrawal and you're subject to government charges and other bank fees.

So you finish up probably about square with your $1000 and you say to yourself, "Well, I didn't win much," but you have the thought that you can withdraw that money at any time it's available to you. Now had the $1000 been put into a superannuation fund for you or by you, you've got to wait until five years, two years, 10 years, 20 years before you can draw it out. So that's a disadvantage but what's it worth a year later? I think a lot of people who do the sums would be surprised. The arithmetic - I would suggest that it's worth about $700 if you omit the surcharge. In other words, put it in for 12 months and you lost $300 within a year. I think it's a discouragement. And so in the issues paper that was kindly sent to me, where it said that the purpose - I think page 9:

The purpose of the superannuation is to encourage people to save for their retirement.

Here we have a case where in one year it's $700. If that's encouragement, we want less of it. Let's have "discouragement" and see what happens. It's a big loss. Of that $300 loss, half, 150, of it represents the contribution tax - the minimum surcharge. It seems conflicting with the objective to pay that up front rather than later. But that's not in the terms of reference.

MR COSGROVE: No, we're not allowed to look at tax matters, I'm afraid.

MR McAULEY: So we put that aside. About $100 of it would represent the loss of value disclosed by funds, and that's indicated by this graph.

MR COSGROVE: Oh, yes.

MR McAULEY: You can see that over the past 15, 16, 17 months the value of managed funds has been on the downgrade for about a year. It's worse, and much more than the All Ords which have been up and down. The managed funds would include a number of superannuation funds. These are my own figures.

MR COSGROVE: Mm'hm.

MR McAULEY: It's a very distinct downwards trend and takes a very brave man to suggest that it's going to finish - the trend is going to start moving upwards or steady-out in the near future. It's a loss of roughly about 10 per cent. So that's $100. The other 5 per cent would represent his up-front fees and so on. So all-in-all there's this 15 per cent contribution tax, 10 per cent price fall, 5 per cent fees; a total of 30 per cent. Have I got that right? 15, 10 is 25 plus 5 is 30; 30 per cent is lost. That's not encouraging savings via investment. It is not. What is happening is, in my view, in the superannuation industry generally in certain respects I would term it as cheating and malpractice. Apparently it's okay to do that. If it was found to be misleading and deceptive, that's different. That's proscribed by Corporations Law, section 995. That's not okay but it's okay if it's cheating and malpractice, in my view.

My main complaint relates to performance rates. I believe these are incorrectly calculated, exaggerate the rates, have no justification whatsoever. The method that's used by the industry generally is set out in this document, Standard 6.00 put out by IFSA. It's, I think, defective in a number of aspects. I mention three in my paper. I don't think I need to go into those at this stage unless you - - -

MR COSGROVE: We've read the written paper, yes.

MR McAULEY: I'm quite happy to answer any questions about that. As far as malpractice is concerned, I would regard the use of compounding rates as falling into that category because, I think, in year 1 - or at least the initial one where you've got a certain amount for distribution; that amount, whether or not it's actually distributed, that ought to be treated as part of the capital that's invested in year 2, and so the base amount for the investment in year two is that augmented amount. I think that's a fairer way to look at the rates in years 2, 3, et cetera; that in year 2 the performance in year 2, we shouldn't allow the rate to be exaggerated by virtue of what was earned the previous year. We should concern ourselves only with the earning rate in year 2 on the base date - and on the base date which includes year one earnings.

My reservations about the performance rates of course apply to all managed funds, including super. I think that's about all I need say because if you've read my paper you may have a few questions to ask me and - - -

MR COSGROVE: No, no, that's fine. I think this may be to some extent an educational issue. Had, for example, you drawn a graph - as you have in this document - based on, let's say, the previous 18 months, then it would have shown a very different picture. It would have had fairly strong growth in returns on managed funds, I'm pretty sure.

MR McAULEY: Excuse me, but isn't that what I've done?

MR COSGROVE: I'm just trying to focus on the particular period. See, you've taken the period from January 2000 to April 2001.

MR McAULEY: That's correct.

MR COSGROVE: And most of the decline in your calculated return on managed funds dates from about - well, let's say March - sorry, about August.

MR McAULEY: August, yes.

MR COSGROVE: Last year.

MR McAULEY: Yes.

MR COSGROVE: So that conveys a picture of, you know, as you've said - - -

MR McAULEY: Very much - - -

MR COSGROVE: - - - not a very encouraging rate of return on these investments.

MR McAULEY: True.

MR COSGROVE: However, if you had a similar chart that ran from, say, the middle of 1998 up to the end of 1999, then I think you would have had a real return on managed funds and on the All Ordinaries, which was rising. So my point, I think, Mr McAuley, is simply that a lot here hangs on whether or not people - particularly people in superannuation fund investments - should be very concerned about, you know, annual volatility, if you like, in their rates of return. Now, you might favour an approach - by perhaps requiring fund trustees to invest in relatively secure assets like bonds or fixed interest deposits or what have you - that would have the effect of minimising volatility from period to period. I'm not saying you would but that's one possibility. But the long-term consequences of such a strategy of course is to reduce the overall return, let's say over a period of 20 years, to the member of that fund. Now, I don't disagree with you that - I'm sure there are some people who look at short-term rates of return and say, "Well, this doesn't look very good. Why am I in this thing?" but really, depending of course on your age - the average age of people in the workforce at present I imagine is not much more than 40, if that, probably less - those people still have investment lives ahead of them of 20, 30 years and they really shouldn't be too concerned about what's happening in a particular 12 or 18-month period, they're focus should be on how their stream of investment returns over that period is developing with a view to providing them with a satisfactory retirement income. I don't know, this may seem slightly academic to you but I - - -

MR McAULEY: No, not academic. It's what the funds themselves say to their potential customers. I don't go along with it whatsoever because some of us have one year to go - - -

MR COSGROVE: Absolutely, yes. I said "depending on your age".

MR McAULEY: Some might have 30 years. There's no way out of - I'm not suggesting there's a way out of the volatility of the market necessarily by going into fixed - that's what I would - that's all. But my main point is this principle of encouragement. There is little encouragement on the basis of what has been happening in the last year; this is just an example. To go back further and to say, well, have a graph of five years or 10 years or 20 years might be a different picture. But that's all irrelevant to the person who is looking at it here and now and saying to himself, "Why has my $1000 gone down to $700?" or $550 if he's got the surcharge. I think your argument, you could repeat till your blue in the face; you're not going to convince the fellow who's lost his money.

MR COSGROVE: That's why I said at the outset that I think it is an educational matter because if a person wants to avoid the sort of period that you've graphed here for us then I think that person does have to invest in bonds and fixed interests, and perhaps even bonds won't necessarily do the job for them; fixed interest would, I think. But the person is then - well, it depends on the purpose of the investment. Now, I think if you're just making a general voluntary investment outside, I mean, the fold of superannuation policy, retirement incomes policy, then that's fine. You can trust your own judgment on that and your own choice of investment strategy. But if you are, in part as a result of government compulsion but in part also as a result of your own voluntary contributions, trying to develop a level of assets which will maximise your retirement income then - and again, as I say, subject to your age most people on average will find it advantageous to invest in growth assets, which are volatile, highly volatile. You know, you might get one or two years out of five when you experience declines but if you look at the five years as a whole you will have gained - gained more than by investing in secure investments on the whole.

MR McAULEY: It's a great theory and it's very comforting and thank you very much. I don't see it as an education-type thing, it's more of a marketing ploy in my opinion.

MR COSGROVE: That may be an issue that warrants some attention, I think. I was going to ask you in respect of that document you showed us, the Standard 6.00, have you raised with IFSA your concerns about their methodology?

MR McAULEY: Yes, and have failed to get a response.

MR COSGROVE: I see.

MR McAULEY: I don't think they want to talk about it because the basic point I put to them was, what is the justification for the performance return being based upon at the purchase date the exit price? A very difficult question to answer, isn't it?

MR COSGROVE: Well, we'll have a chance to ask it because - - -

MR McAULEY: That's great.

MR COSGROVE: - - - we expect that they will be appearing before us in Melbourne.

MR McAULEY: Because it's not only the difference between the exit price and the entry price which in some funds is about 3 per cent, a very important factor, it also relates to the additional entry cost. So if you want to work out the performance return on an investment for any given period you must base it on the purchase costs. It's no use basing it on some other figure - so those two things, and I think there's another - I have mentioned there the fact that as far as short-term rates are concerned it's ridiculous to have only a one-year rate calculated at times when the market is nosediving, for example. We have a case only in the last 12 months where a fund was quoting 34 per cent as being the one-year rate on this particular fund. It was absolute - well, it was, I'd say cheating, even misleading, because what was happening the fund had virtually ceased to make any distribution whatsoever and the market value was declining for quite a number of months. So to quote 34 per cent - of course, we're all after 34 per cent for our money and if we hold this particular fund we won't sell it, we'll hang on to it. But that was completely the wrong situation and I think in the next quarter or two the rate fell from 34 per cent to a minus figure. There's no justification for publishing rates which absolutely mislead and are deceptive.

MR COSGROVE: Yes. There is usually a little footnote to those tables, isn't there, "Past performance is no guide to future returns."

MR McAULEY: We might as well forget about them because there's no other good indicator, is there, of a fund's performance. I don't know of any, even - - -

MR COSGROVE: Some of the - I guess you might call them rating agencies, do publish in some of the major newspapers three months - well, more likely - yes, I think you see some who show three months. You don't often see six months, I think, do you? It's usually three months, one year, three years, five years, that sort of - - -

MR McAULEY: The official thing according to the S6.00 is officially one, three, five and seven and 10, I think.

MR COSGROVE: Yes, I can see your point about the possible misleading impressions that can be given by - - -

MR McAULEY: Yes, the point though is that in general the rating agencies are not privy to any special information that enables them to have a more accurate performance rate. No, the footnote will say that they're accepting the rates as calculated by the funds themselves. The other thing which I'd like to make clear, I think it's very important that we have a regulator that does spot check the published performance rates. I think it's ridiculous that the regulator doesn't do that and in fact refuses to check the rate even when a person, a member of the public, complains about a particular rate. An instance that I'm aware of, the ASIC wrote back to say that it wasn't in a position to check the rate - it wasn't in a position. Now, I don't know how you - I know my interpretation of that. But I think by legislation the regulator ought to be required to confirm rates as being reasonably accurate by spot checking or doing some sort of an audit, or certainly checking on a complaint.

MR COSGROVE: There was one other aspect of your submission, Mr McAuley, that I wanted to ask you about. It was the point you make early on that - and it's I think potentially relevant to our inquiry certainly:

> In order to increase and improve competition in the issue of super products artificial and unnecessary legislative demarcations be abolished between financial organisations which are denied and those which are approved to issue superannuation products.

What are those legislative demarcations that you had in mind?

MR McAULEY: As I understand it, the Commonwealth Bank's company that manages unit trusts other than super can't issue super products. It has to set up its own Commonwealth Bank's life company. This applies I think to all of the other major - BT has a life company to issue the superannuation as a life product. I don't see any value in having those sort of demarcations because the staff handling the products are all the same, whether they're superannuation or other.

MR COSGROVE: So is this - I'm not sure I'm quite understanding your point. Is this really a function of the need to establish a trustee structure in order to create a superannuation fund?

MR McAULEY: That's part of the legal framework that's set up. In the case of super it's trustees are the people. In the case of other managed trusts there are no trustees, only managers.

MR COSGROVE: Yes. So that's the essential distinction, is it?

MR McAULEY: Yes, as I understand it.

MR COSGROVE: Yes, I see.

MR McAULEY: It's just a ridiculous distinction, in my view - and similarly with the people who handle or advise on the products; they're divided up into these categories. As an investment adviser I'm not able to handle superannuation because I've got to be a broker or have a broker's licence for that. I can't see reason for these things. I think it inhibits competition. It's just a cost which the industry bears and it doesn't make any sense. I quite realise that there is a legal framework which precludes this from being easily overcome. You'd have to go through the legislation and clean it up.

MR COSGROVE: Okay, thank you very much. I think you've covered the points very well. Thank you very much for making a submission to the inquiry.

MR McAULEY: Good. It was a pleasure.

MR FRENEY: Thank you, Mr McAuley.

MR COSGROVE: That concludes our hearing today, so we will adjourn and resume in Melbourne on 15 May. Thank you.

AT 4 PM THE INQUIRY WAS ADJOURNED UNTIL TUESDAY, 15 MAY 2001

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