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TRANSCRIPT OF PROCEEDINGS

PRODUCTIVITY COMMISSION

DRAFT REPORT ON THE SUPERANNUATION INDUSTRY

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

TRANSCRIPT OF PROCEEDINGS

AT SYDNEY ON THURSDAY, 25 OCTOBER 2001, AT 9.50 AM

Continued from 16/5/01

MR COSGROVE: Good morning, ladies and gentlemen. I'd like to welcome you to the public hearings on the Productivity Commission's inquiry into the SIS Act as it's known and certain other superannuation legislation following the release of our draft report on 19 September. My name is John Cosgrove. I'm the presiding Commissioner on the inquiry and with me is my fellow commissioner, Roger Freney. The purpose of this round of hearings is to facilitate public scrutiny of the Commission's work to date and to receive comment and feedback on the draft report. Following this hearing in Sydney, hearings will also be held in Melbourne next week and we will then be working towards completing a final report which we plan to give to the government in December, having considered all the evidence presented at hearings and in submissions as well as other informal discussions.

Participants in this inquiry will automatically receive a copy of the final report once it's released by the government which may be up to 25 parliamentary sitting days after we supply it to the government. We like to conduct these hearings in a reasonably informal manner but as you can see, we are taking a full transcript of proceedings and for this reason we can't take comments from the floor but at the end of proceedings today I'll provide an opportunity for anyone wishing to do so to make a brief presentation to us.

Participants are not required to take an oath but we do ask them to be truthful and accurate in their remarks and of course they're welcome to comment on issues raised in submissions other than their own if they wish. The transcript of our hearing will be made available to participants and will also be available from the Commission's web site following the hearings. Copies can also be purchased using an order form available from our staff who are here today. Submissions are also available if people wish to have them. So I would now like to welcome our first participant in this hearing today which is the Institute of Actuaries of Australia and I would like to ask you both, if you would, to identify yourselves and the capacity in which you are with us today.

MS MARTIN: Thank you. I'm Helen Martin, 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 both. We have a further submission from the Institute on the draft report. You would like to speak to it, I would imagine.

MS MARTIN: I would just make a few brief opening comments and then leave it to you to ask us any particular questions that you may have. Firstly, as we said in our submission, I'd like to commend the Commission on its comprehensive report and analysis and also on the consultation process that has been followed so far. The Institute supports many of the recommendations and views expressed in the draft report but of course we don't support them all as you will have noted from our

submission. There are others I think where we feel there's a need for further clarification. Some of the recommendations that we support in particular were the proposals to simplify specific aspects of the legislation such as the contribution and cashing of benefits requirements, reviewing some of the pension provisions and some of the requirements for actuarial certification.

When it comes to our particular concerns, I guess they're primarily around the net tangible asset and capital requirements for both approved trustees and trustees that are not approved trustees and we would certainly advocate in the case of non-approved trustees that alternative mechanisms to achieve the same outcome be considered rather than just capital requirements. The other area, I guess, of significant concern is the potential impact of the licensing of trustees. I think substantially the impact of that on the industry will depend on what the particular requirements are and so we would be very concerned to ensure that the requirements were not overly onerous, again, particularly on the inner corporate and so-called not-for-profit funds.

APRA, we're aware, made a number of recommendations in its submissions to the Commission and some of those are also reflected in the recent issues paper released by Joe Hockey. Some of those proposals of APRA we would support, including consideration of the review of the structure of the legislation into the three tiers of legislation and then prudential standards and then guidance notes. It would be a significant effort to do that but we think it provides significant opportunity for streamlining and simplifying the legislation for clearly separating the different objectives of the legislation, the prudential requirements versus the retirement incomes and other requirements and also allows more flexibility to adapt the legislation and the requirements and guidance notes as circumstances change.

We also in our submission made some comments on proposed investment requirements and in particular APRA's suggestion that the requirement for trustees to formalise their investment decision-making should be increased and we would support that proposal. That's probably all I'd like to say at this point and then I'll leave it to you to ask any particular questions that you may have.

MR COSGROVE: Thanks, Helen. We had notified you a short time before these hearings of some particular matters which your submission raised in our minds. If you don't mind, I thought we might begin with some of those to see if you can help us on those scores.

MS MARTIN: Certainly.

MR COSGROVE: The first one was the statement you made at the top of page 2, or it actually begins at the bottom of the preceding page but at the top of page 2 of your submission you say:

> In practice, compliance costs have increased steadily in the last 15 years but this has been offset by increasing administrative efficiency due to technological advances.

One point about that that I'd like you to clarify for us if you could is this vexed question of compliance costs relates to the tax aspects of superannuation, vis-a-vis the non-tax aspects. Now, I know you yourself might have told us this - in our earlier stage of this inquiry people were telling us that it was the tax-related compliance costs which were more of a burden to them than the costs of complying with the non-tax elements of the SIS Act. Is that how you see it or are there still non-tax compliance costs which you consider have increased steadily, as you say, over the last decade or so?

MS MARTIN: I think there probably has been an increase in the SIS compliance costs in the last decade or so. As there are more and more provisions put in SIS with which trustees have to comply, then quite clearly that has a cost impact for the trustee in considering what the requirements are and implementing what - - -

MR COSGROVE: What examples would you cite in there?

MS MARTIN: Extensions to the requirements to be included in actuarial reports under SIS for example and the most recent SIS requirements for pension asset certification under modification declaration 23. Just in terms of member reporting requirements I think have got more extensive in recent years and the amount of information and the timing of getting information to members has changed and so there has been a need for trustees to constantly review and add to the information that they have to provide to members. I'm sure there are others but I can't think of any others.

MR MARONEY: Perhaps I could just suggest a general one is the continual change in arrangements, even if it's not so much - each change itself sort of looks okay but the process of continually changing does have an ongoing cascading effect through the system of people having to put a lot of effort into upgrading systems and then checking that the things have been upgraded correctly and probably changing systems more quickly because they end up sort of not able to cope with just the constant year by year sort of change.

MR COSGROVE: Has this required increased use of people with actuarial skills and have you had to expand your workforces to deal with the requirements of trustees under the act?

MR MARONEY: I would have said it was more in non-actuarial areas than actuarial but there would - some of the examples Helen has quoted have certainly increased some of the compliance roles that actuaries have been involved in.

MS MARTIN: I think there has been an increase in administration requirements,

auditing requirements, need to get legal advice and also in some cases need to get additional actuarial advice. It's very difficult to quantify the cost and the proportion of the cost that is, you know, for SIS compliance versus tax compliance versus what you have to do just to run a fund. I'm not aware of any analysis that has been done. In fact, I think it would be extraordinarily difficult to do a comprehensive analysis that would generate reliable results. A quick sounding of some superannuation committee members of the institute to get a gut feel has said that maybe you could reduce compliance or administration costs by around 10 per cent if you got rid of some of what we would see as unnecessary SIS requirements.

Whether that is right or not, I don't know. I guess you have to bear in mind that even if some of the member reporting requirements were not included in SIS then trustees would probably do a lot of the member reporting anyway so the extent to which costs would be reduced by removing those requirements is hard to quantify but certainly I think there could be some reductions in charges to funds or costs to funds if there was some simplification or streamlining of the legislation, the SIS legislation.

MR COSGROVE: Would you expect any such reductions in charges to flow on to members in the end?

MS MARTIN: Almost certainly. It would depend on the type of fund of course but certainly a lot of the accumulation funds and public offer funds, the expenses are paid directly by members so any reduction in expenses would flow directly through to members. There are other corporate funds where the employer bears the cost of the expenses but even there you would have to argue that a reduction in costs to the employer is to the advantage of the members because the employer may decide to improve benefits or do other things with the cost that it's otherwise paying for administration.

MR FRENEY: Yes, thank you. I noticed you used the word "unnecessary" and that's what caught my notice that perhaps that's what we need to focus on because presumably many of the SIS requirements are intended to have certain benefits for the prudent management of superannuation funds and I guess we have to think of a base case sort of situation where you didn't have legislation but you had a reasonably operating system without it. So it's the unnecessary requirements of SIS that we might focus on. Can you give us an impression of the significance of the unnecessary elements of it, Helen?

MS MARTIN: Again, it's hard to judge. I mean, I think one example would be a requirement for an accumulation fund that has allocated pensions to get an actuarial certification about the amount of assets that should be exempt from tax. For an allocated pension fund the account balance is the assets and therefore the need to get an actuary to certify that seems a bit pointless. There are not many examples like that. I would argue that - again, some of the detail in the member reporting is unnecessary that, you know, whilst yes, it is very important that members understand

what their account balances are and what their coverage for death and disability benefits might be, the current member reporting requirements go far beyond that and I think you end up with a communication statement to members that is far more than they need and are interested in and therefore they don't pay attention to and so it doesn't achieve its objective of informing members.

You would really need to sit down and go quite carefully through the SIS legislation to try and identify all the elements that you think are unnecessary. I don't think it's huge but I think there are certainly some things there.

MR COSGROVE: We had raised a similar sort of question in terms of the costs incurred by life insurance companies. Again, I guess quantification is almost impossible but do you have any thoughts on areas there where, using Roger's terminology, "unnecessary compliance costs are capable of being reduced."

MS MARTIN: I actually passed this one on to our life insurance committee to come back on and again they had the same comment, it's very difficult to quantify. The concerns that they have are really to do with, yes, there's some additional costs but it's additional hassle and effort and duplication in requiring them to comply with both the Life Act and the SIS Act because you've got separate accounting under SIS and life insurance. You've got duplicated auditing because you need to have the life insurance accounts audited but you also need to comply with the SIS auditing requirements. Some of the governance requirements are duplicated because you've got some under one act and some under the other. They have indicated duplicated capital requirements now. I don't quite understand what that entails but it obviously has an impact on it.

Whether there would be significant savings if they didn't have to comply with SIS and only had to comply with the Life Insurance Act, the view was that there probably - it's not a significant percentage of overall costs for the life office but it would have an impact if they only had to comply with one set of requirements. Obviously if you did make that change you would need to think through some of the transition arrangements. At the moment you have a trustee in place who is making distribution decisions and those sorts of things and if you remove that trust structure for those sorts of arrangements you need to decide where those requirements would fall.

The other comment they made was that because the extra costs are not a significant percentage of overall costs, it's hard to see significant savings flowing through to members if you did make that change. But there certainly would be some savings and it's worth considering.

MR FRENEY: Can I ask you in that area please, Helen, whether your colleagues have any sense about the robustness of the Life Insurance Act requirements to protect superannuation in a prudent management sense that is in the statutory funds in the life companies?

MS MARTIN: It wasn't something that I specifically asked them or that they specifically expressed a view on, but I think our view generally would be that the Life Insurance Act requirements for the life companies are fairly sound. There are certainly strong capital requirements and prudential requirements, the need to keep separate statutory funds and the like, all of which are aimed at making sure that life insurance organisations are financially strong and prudentially looking after the interests of the policy holders. So we would feel that would provide sufficient protection for individuals taking out superannuation policies.

MR MARONEY: I would just reinforce those comments. I suppose it does get to that basic question in terms of from a neutrality point of view if you weren't going to impose a trust structure on the life company arrangements because they have equivalent functions under the Life Insurance Act, is that essentially adding to competition by removing an artificial sort of overlay, or is it sort of creating an advantageous capability for life insurers to compete in the superannuation side by having a more stream-line set of regulation that suits them. I think it gets overtaken by tax issues and there has been much more concern in terms of whether life insurers would keep conducting superannuation through their statutory funds post the new tax system for life insurers. I think the regulatory side there is much less a significant issue in terms of the competitive framework compared to the life insurance tax rules, vis-a-vis the tax of superannuation that is conducted outside life insurance.

MR COSGROVE: Could you expand on that tax aspect for me please?

MR MARONEY: Perhaps to put it in its clearest terms the original proposals in the reforms the government announced would have seen an increase in the tax bill for the life insurance industry of around $700 million and given that 80 per cent plus of what the life insurers do is superannuation, most of that was going to be increased tax on operating superannuation through life companies. A lot of the reaction from life companies was if it goes down that route, then it would be more advantageous for them to operate superannuation business outside the statutory funds and most of them have the option to do that. Part of that was removing some tax benefits that were accruing to life office shareholders, in particular franking credits was an area where the shareholders were getting benefits out of a formula for distributing franking credits that really was somewhat arbitrary, rather than appropriate.

So there were quite a number of things being dealt with in other areas on what happens with superannuation benefits when they get to retirement time from the accumulation to rolling them across into allocated pensions. There is certainly now a tax advantage to do that outside the life office environment than inside it, so there are a number of factors there that have been built up over the time, but they are quite significant in terms of financial impact and probably much more significant than issues of whether the trust structure remains, though it does. If there are no other differences it would then be a factor which would lead to doing it in a less duplicated regulatory environment, ie outside the life company rather than through the life

company, which does have some implications for the prudential side, given that there are more onerous requirements in capital et cetera.

MR FRENEY: Could I ask another question in this area just for my edification. As I understand it, the actuarial standards that relate to life insurance companies have got certain reserving requirements built into them to protect against certain kinds of identified risks and so you make calculations of how life companies ought to be reserving against certain kinds of risks. That is with respect to moneys that are in the statutory funds of the life companies. I was just wondering a little laterally in the sense that a lot of that is superannuation money and it is dealing with very long life products that have certain risks attaching to them or to the supplier. Would there be any analogy with superannuation more generally, that if you are thinking of reserving against risks happening in the statutory funds of life insurance companies from money that's in there, could you also think in terms of setting these kinds of reserving requirements for superannuation moneys more generally, for example, particularly perhaps for defined benefit funds?

MR MARONEY: On the defined benefit fund area, the promises there are essentially coming from the sponsor of the defined benefit, rather than the financial institutions. So if a life office is running a defined benefit fund, it was very rare that a guarantee would be coming from the life insurer. There is now more of that as defined benefit funds have gone into master trusts where the master trust would essentially be backed by a financial provider of some sort, including life offices. So there are some guarantees there. I am just trying to think how that feeds through into the life office reserve. It tends not to in terms of that would relate to how the trust itself is being run and then the life insurer is essentially pretty much exclusively on that sort of business holding reserves that relate to more operational risk, rather than a promise of a benefit like there is on the death benefit of standard life insurance and capital guarantee business where there is really a direct promise from the life insurer to pay a dollar amount or to protect the investment against market fluctuations. That is where the main sort of capital requirements come in.

But if you are offering a capital guarantee in investing in the share market, there are certain formulas and components that go in there to take market risk and credit risk into account in setting aside the capital. But in all those cases there is also then an operational risk sort of component that pretty much is saying that if you run into difficulties you need to have enough capital that will actually deal with just the operational side of keeping the business going for a while while the problems get sorted out. That is probably the main area of difference and that is more in the accumulation fund side between superannuation run through a life office and run outside a life office is a specific operational risk component in the capital that is required. So the base level of capital is then there are two buffers on that, one as a solvency sort of measure and a capital adequacy measure that take account of different degrees of risk in terms of for capital adequacy, that is the company is sufficiently financially robust to be able to keep writing new business and has enough capital to do that over, say, a three-year business plan exercise, where

solvency is looking very much at if you shut the business down now there is a reasonable chance that you would be able to pay out all liabilities, but without taking into account what happens over the next few years in putting more business on the books. So there is quite an involved approach as you are probably aware from your background in terms of those components. So some of it I think is analogous to what could be done in the superannuation area for having capital to reflect operational risks.

MR FRENEY: That is what I was wondering. To put it perhaps a bit crudely and simplemindedly, if it is considered necessary in actuarial standards to have these reserving requirements for life insurance-type products and for superannuation moneys that are going into the statutory funds of a lot of companies, query, why shouldn't conceptually the same reserving ideas apply to other superannuation moneys?

MR MARONEY: I suppose to me it comes down philosophically to, do you want the same level of protection for all superannuation moneys, or does that become another factor in the risk return spectrum that; yes, there is a higher degree of protection if you are doing your superannuation through a life insurance company to the extent that capital is held for a range of purposes, including operational risk, compared to the alternative that doesn't. But in a sense you are having to pay for the capital that is retained there, so it is more likely prima facie to be a more expensive way of saving for your retirement, so this might be a less expensive way that has some extra risk attached to it in terms of operational side and it is really then a question of do you want the marketplace to have just one level of protection or do you want to offer a range of protections that people can choose between?

MS MARTIN: I think this comes back to the point which we alluded to in our submission but didn't go into a huge amount of detail in, that there are a number of different ways that you can protect against some of those operational risks and solvency risks. In its simplest form, if you think about a superannuation fund, what is fundamentally important is that if it is wound up tomorrow that all of the members get their resignation entitlements at that time. Now, there is actually a standard already in SIS that says you have to have 100 per cent coverage of vested benefits and if you don't you have to have a plan in place to get back to that point.

Issues arise there I guess if you get a sudden dip in investments and you suddenly have to pay out all the benefits, then how do you protect against that risk? APRA's proposal is to have tight investment policy and strategy requirements and to get professional advice on setting investments and have diversification and the like can address that risk to some extent. The other issue is not having the contributions transferred into the fund at the right time and that is really a sort of tax compliance issue. A lot of the operational risks for funds are transferred to third party providers like administrators and the like. I mean the super fund itself is not going to, unless it is in-house administered for example, there are not going to be issues there in terms of it not being able to conduct its business, because it doesn't really have a business.

It's often administered by a third party provider.

So imposing capital requirements on the fund itself isn't necessarily required if you can address the risks that you are trying to address in different ways. I would also comment that some of the thinking behind the modification declaration 23 pension certification which says that you have to certify that there is a high probability of providing the pensions that have been promised, APRA's thinking behind that was actually trying to translate the life insurance reserving requirements for pensions and annuities to the superannuation arena and saying that when they say high probability they want an 80 per cent probability that there are enough funds there to be able to pay out the pensions that have been promised and that 80 per cent number derives to some extent from the way the reserving in the Life Insurance Act and actuarial standard works for life insurance.

MR FRENEY: Thank you.

MR COSGROVE: In that comparison of life company provided superannuation and regular superannuation fund products, you referred to a higher level of expense that might be involved in the case of a life company product. Would there also be lower rates of return associated with the higher level of - "certainty" is not the word I am looking for, but a higher level of confidence in the availability of benefits with the life company product, or is that not the case?

MR MARONEY: Pretty hard to make a comparison there.

MR COSGROVE: I am just thinking of the spectrum of risk point.

MR MARONEY: Yes, the offerings generally from the life companies, master trusts and to a lesser extent industry funds and others that have a smaller number of investment choices do tend to cover the whole spectrum. So you can have very high expected returns with high volatility, by through most life companies you could invest fully in Australian shares or international shares. Similarly, you could go to the other end of the risk spectrum and be in a capital guaranteed product, whether it is an RSA or something that looks like that. So the full spectrum is sort of offered - - -

MR COSGROVE: Available to the contributor.

MR MARONEY: - - - and there is much more sort of member exercise investment choice in the commercial sort of superannuation version generally than in the non-public office side. So it is probably hard to draw any conclusions as to relative investment performance. It would then be a matter of looking at are there any constraints where you are offering a similar product for an Australian equities offering from a life company as against an on-life company and I think you might have some evidence over time that the more relates to the size of the funds under management that generally the larger funds are less nimble and over time have

probably had less higher returns. But it is probably also tied in with some lower volatility there. Helen might have some more too.

MR COSGROVE: Okay, thank you.

MR FRENEY: Before we move away from the Life Insurance Act, we said in our draft report that we could see some merits in perhaps eliminating duplication between SIS and the Life Insurance Act and relying on the Life Insurance Act for the prudent management aspect, not some of the retirement income objectives obviously of the SIS Act, and that we were relatively attracted to this concept. I can't remember from your recent submission whether you've actually addressed a sort of a conclusion about this. But could I just ask whether the institute has a view on this draft recommendation of ours?

MS MARTIN: Yes. I think we're supportive of looking at it and seeing whether it can work in consultation with industry.

MR FRENEY: Thank you.

MR COSGROVE: Another question which we'd ask you about concerned your assessment I guess that the licensing proposal in the draft report would accelerate a trend towards closure of corporate funds. In fact you saw that as likely to accelerate dramatically. I wonder if you could tell us why you think that would be the case.

MS MARTIN: I think, as I said in my opening comments, it depends significantly on what the licensing requirements are and how onerous they are.

MR COSGROVE: Yes.

MS MARTIN: But I think primarily it comes back to both costs and time, sort of difficulty of compliance issues, and if the licensing requirements are viewed by the sponsors of the funds as imposing additional costs on them or making it more difficult for them to operate a fund or, you know, that the competency tests and the ongoing sort of assessment of competency requirements is too onerous, then a lot of particularly smaller employer sponsors will just say, "Well, this is all too hard and it's costing us too much money. We may as well let our employees make their own choice about a retail fund or a personal superannuation arrangement."

MR COSGROVE: We didn't of course, in the draft report, propose that there would be any minimal capital requirement for non-approved trustees, other than a working capital requirement, and in terms of licensing condition, well, the examples which we gave were demonstrating that you had some general capacity to operate an entity, the operating capital point that I mentioned, supplying the regulator with an investment strategy using an independent auditor as well as an approved dispute resolution scheme. They're shown at the bottom of pages 119 and the top of 120. So in terms of additional direct capital costs, if there are any, that would relate to the

operating capital side.

Now, wouldn't you ordinarily expect that even a small corporate fund would need to have some operating capital to guard against risk of failures in its accounting or computer systems? In other words, I'm wondering how much of an additional impost that particular element of the proposal would require. It may not be a very easy question for you people to answer.

MS MARTIN: Yes, that's right. It might be a better question for some of the administrators I guess. I mean, certainly most funds would need some sort of, you know, cash account or float to be able to continue to operate and pay expenses and benefits and the like.

MR COSGROVE: It may be an implicit part of the employer's overall business costs and it's sort of not identified separately at present.

MS MARTIN: That's right, particularly if you've got an in-house administration arrangement with an employer. Then presumably in the broader context of the employer's business they would have, you know, operating capital set aside to cover a whole host of risks. In the case of where you've got third party providers involved then it's the third party provider who would have the operational capital set aside to ensure that if their computer system fell over they could get it up and running again and those sorts of things. I guess we were more concerned about any additional capital requirement that might be imposed beyond just sort of the operational capital requirements.

MR COSGROVE: I thought that might be the case, which is why I was looking back again at our - - -

MS MARTIN: And certainly, I mean, we don't have - it's difficult to object to some of your suggestions in terms of investment strategy and the like as well. I think it's just a case of employers making an overall assessment as to whether the hurdles are getting higher and higher that they have to meet.

MR COSGROVE: So a straw that breaks the camel's back perhaps.

MS MARTIN: In some sense, some of this is likely to emerge anyway under the Financial Service Reform Act and where we end up with the licensing requirement for ASIC under that act and what exclusions or other requirements there might be, depending on the nature of the operations of the fund. In essence I think we're going to continue to see a trend of some of the smaller funds closing and transferring their members to master trusts or giving them the choice of having personal superannuation arrangements and the like. It's just a question of whether we want to do anything that accelerates that trend or not, and I think we'd suggest caution in moving that way.

MR COSGROVE: You may not be making a judgment of this kind, Helen, but implicit in your comment seems to be a view that small corporate funds may well be able to serve their members' interests better than, say, a larger retail fund or some sort of master trust arrangements.

MS MARTIN: I think that's true. I think there are some very good and capable and competent small to mid-sized funds out there that have the interests of their members at heart, that operate efficiently and effectively and provide good service to their members, and it would be a pity to see those close down unnecessarily.

MR FRENEY: Could I just ask a question in this area, that the issue in my mind is the amount of independence and capacity that the superannuation fund entity per se should be having, having regard to the prudent management and protective sort of objectives of the SIS Act. Insofar as you don't have reasonable capacity and independence of the superannuation entity, of a corporate fund or an employer sponsored fund, then it seems to me that there's a higher risk facing the members of that fund in the event that an employer runs into difficulties and can't separate the running of the fund, or indeed the assets of the fund that are needed to run the fund, from the running of the employer itself. So I don't know whether you have any comment on that, but in a way that's an issue in my mind.

MS MARTIN: I think the nature of the SIS requirements and the requirement to have a separate trust arrangement with a superannuation fund should mean that the assets are separate from the business of the employer. The only issue then becomes, is the employer actually funding the superannuation fund to the extent that's required?

MR FRENEY: That's right.

MS MARTIN: That's, in part, a Tax Office issue I suppose. If the employer is not making its minimum super guaranteed contributions then that's something for the Tax Office to act on. I mean, the reality is that a lot of the mid-sized funds do get independent advice and do have people designated as the employer to focus on superannuation, if not all of their job certainly as a significant component of their job. The more significant questions probably arise at the very, very small end of the market, the less than five sort of small business ones which are supervised by the Tax Office and there the issues are quite different because they don't have expertise. They may not be aware of all the requirements that they're meant to be complying with and so there may be some more significant risks there.

MR FRENEY: Yes. I have in mind the running of the fund, the operating, the administrative structure that's needed to run a fund. With respect to defined benefit funds, when you're making calculations of the availabilities of money, of the solvency and the liquidity and the availability of money in the future, does this question of the funding of the administration of the fund and the computer systems that are required and the staff that are required to run the fund - do they come into

your figuring and how are they costed? Are they costed sort of out of employer resources or are they costed out of the resources of the fund?

MS MARTIN: It depends on the situation, but certainly in projecting the future cash flows of the superannuation arrangement and, you know, what outgoing is there likely to be required over the future lifetime of the fund, we would look at not just benefit payments to members but also administration costs and other cash flows, ins and outs like, you know, insurance to offset death and disability claims and the like. At the end of the day we pull all that together and recommend a funding requirement which may be an employer funding requirement or it may be - but we assume that the moneys to cover both benefits and all expenses will be paid into the fund and therefore be available to come out of the fund to pay the expenses, if you like, and so it gets reflected in what we tell the employer the cost of the fund would be.

MR FRENEY: In what proportion of employer sponsored funds or to defined benefit funds would your assumptions be on the basis that the employer was going to be keeping funding the administration of the defined benefit fund? Is it a very common practice, that you'd be assuming that the employer would be continuing to fund the administration or not?

MS MARTIN: Yes. It's just a question of whether it pays those expenses directly or whether it pays the money into the fund and then has them paid from the fund. But either way, the costs have to be met.

MR FRENEY: Right. So typically it wouldn't be assuming it was coming out of earnings of the assets of the fund?

MS MARTIN: No, not typically. In some cases it would be, but not typically.

MR FRENEY: Thanks very much.

MR COSGROVE: A matter mentioned in your most recent submission to us, which has come up quite a lot during this inquiry, is the four-month reporting requirement for funds with APRA. You've suggested that we should tackle the question from a different direction and ask what benefit derives from this four-month reporting requirement. We have done a little bit of that. Clearly the regulator itself sees some significant advantages for its own purposes in this arrangement. But I was wondering also about the interests of fund members. Would you not say that they could derive some benefit from learning sooner rather than later of the performance o their fund? In other words, is this a requirement which really is in the interests of the fund members, not just the prudential regulator?

MS MARTIN: Yes. I think there's some truth there. There's a separation in my mind between the reporting to members at the end of the fund year and the requirement to submit accounts and APRA returns. One of the most difficult elements of finalising the annual review process and meeting the four-month

requirements is typically getting the accounts finalised and the audits signed off on the accounts, and often times funds will, you know, depending on how they're structured and how they operate, be able to report to members within that four-month time frame but will struggle to meet the accounting and auditing requirements to get the accounts signed off by 31 October. I think it is in the interests of members to be able to report to them quickly after the end of the fund year. Whether you then say that it's important to also be able to submit the terms to APRA, maybe there can be a little bit more flexibility there.

MR COSGROVE: What's the nature of the additional difficulties faced in satisfying APRA's requirements?

MS MARTIN: It's really just trying to get all parties to get all the information together, to be able to finalise the accounts, have the accounts audited and get the returns prepared.

MR COSGROVE: But what's different about that as compared with having a set of accounts which can be provided to members?

MS MARTIN: I'm thinking of the benefit statements that go to members rather than the annual report which includes the accounts, or some of the accounts.

MR MARONEY: The trustees can send out abridged, unaudited accounts to the members.

MR COSGROVE: To the members, I see.

MR MARONEY: Saying that audited statements are then available for members on request and that's quite a normal practice to get the information out to members.

MR COSGROVE: How long - I suppose this is again a question, the answer to which depends on the size of the fund, but is it possible to give us some idea of the amount of time taken to audit a fund's accounts for APRA purposes?

MS MARTIN: It varies very much depending on the complexity of the arrangements. I mean, it's a few weeks - - -

MR COSGROVE: Minimum time would you say - - -

MS MARTIN: And often times it's not one period, it's a backwards and forwards sort of process between the administrator providing information, the auditor looking at it and then going away and requiring more work to be done and coming back. The point we were trying to make in our submission is that for the funds where it's a significant issue and likely to be really difficult for them to comply with the four-month requirement, having a four-month requirement is not necessarily going to catch the funds that you really want to catch, because they won't comply with the

four-month requirement, that having a four-month requirement is not necessarily going to catch the funds that you really want to catch, because they won't comply with the four-month requirement or a six-month requirement, although the good funds will try and do it. So you're really just squeezing the good funds and not necessarily achieving any gain in terms of picking up the noncompliant funds.

The other point we made was that one of the most significant issues with the four-month reporting requirement is that, because most funds are forced to have a 30 June end year, it means that we're talking about one four-month period covering every single superannuation fund in Australia pretty well, and if there could be some spreading out of that requirement over the year and allowing funds to have different reporting years, then the four-month time frame may not be such a big issue.

MR COSGROVE: Yes, we've looked also at that as a possibility and there seem to be some snags from the viewpoint of the Tax Office, for example, but also I think in terms of being able to compare performance across funds. I mean, there is a degree of choice available for some superannuation contributors, not all of them, so it's not clear that that one gets us over this reporting hump issue.

MS MARTIN: True, although I guess we have argued in different forums in relation to sort of consistency of investment performance reporting, so that if there was choice between funds members you could compare 30 June return years. We think you can do that without necessarily forcing APRA reporting and accounting to be done on that same 30 June time frame.

MR COSGROVE: Yes.

MR FRENEY: Do you think this problem is a structural problem in terms of the creation of large approved trustee entities that are handling very many different small funds and the service that they're providing is a difficult one and they're struggling to meet these time frames? I ask that question against the background that it's my understanding that small funds have always had to meet a four-month reporting period, as I was told informally, so I'm trying to understand why this has come up as a problem. Do you have any feel for that?

MR MARONEY: On my understanding the four months is always applied to public offer funds but not to other funds up until fairly recently.

MS MARTIN: I'm not sure whether last year or the year before was the first year that the major non-public offer funds had to comply with the four-months requirement. Before then it only applied to public offer funds. Certainly, it was probably more difficult for more funds in the first year or two and will perhaps get easier over time, but I'm not sure that I'd say it's a structural issue. I think in part it's an issue because of the various parties involved and the need to actually collect information from employers and administrators and investment managers and involve accountants and auditors, get actuarial certificates.

I mean, there's a lot of work that needs to be done to be able to pull together the financial statements and information needed to go with the accounts and the APRA returns, and it can be just difficult from a time point of view. You have to wait until the investment managers are able to provide the investment reports after the end of the year which usually they say they need at least three weeks, if not four weeks, to do. You've also got to make sure you've got all the reporting from the employers in terms of contributions members have left or whatever again. Employers tend to need some time to do that, and so each extra person and step in the process I guess adds extra weeks to the time needed to actually pull it all together and then have the auditor come in and sign off and check through it all and say, "Yes, that's all okay."

MR FRENEY: Which is a more difficult process for smaller funds because they don't have the same administrative capacity as larger funds to meet the four-month deadline.

MS MARTIN: You could argue that it's difficult for the smaller funds because they don't have the resources and the capacity to do it. It's also often difficult for the larger funds because they're more complex and there's more information to be collected and more contributions to be reconciled and the like.

MR COSGROVE: They might have a simpler range of investments so that acquiring information would go faster.

MS MARTIN: Yes.

MR COSGROVE: I look back at your previous submission to us in the earlier part of the inquiry and I wanted to ask you about a point there on - it was under the heading Encouraging Late Retirement, but that section was essentially about the rules governing contributions to funds and at the bottom of page 8 near the end of the submission in fact you said:

> While it may be important to ensure that the rules do not allow money to be left in the superannuation system in order to defer tax -

a point we of course agree with you on -

> the current system does require simplification. For example, up to age 70 there should be no requirement to pay benefits because a member is not working sufficient hours. Also up to that age all types of contributions should be allowed irrespective of the hours worked.

I wonder if what you really seem to be saying there is that the present employment tests applied to particular age categories of contributors are not really necessary, serve no real purpose. Is that reading more into that statement than was intended?

MS MARTIN: No, that's probably a fair comment. I mean, at the moment you have different work tests, whether it's 10 hours a week or 20 hours a week, at different stages, and I guess we would take the view that it would be simpler and easier for funds to comply with and easier for members if you just said, "Well, the limit is 70 and until then you can contribute to superannuation and after then you can't," and that would remove the need to have all those work tests between 65 and 70.

MR COSGROVE: Why are the employment tests at present? I guess this is a question we should have raised with other people.

MS MARTIN: Ask the regulator. I think in part it was because historically 65 was the retirement age and they wanted to ensure that anyone who was contributing and deferring taking their superannuation beyond then was genuinely working rather than just trying to defer tax. I guess I'd argue whether the revenue implications of that are worth the effort that's required to ensure that you're complying with the tests.

MR COSGROVE: You don't see any disadvantages from a policy viewpoint in removing that test?

MS MARTIN: I guess you might end up with some people who are not genuinely working making contributions and receiving deductions and getting sort of concessional tax on investment earnings and the like that they mightn't otherwise get. However, given the changes in lifestyles and health and more people working beyond age 65 in a policy sense, I would argue that we should be encouraging people to work longer and save longer, and therefore there's some policy advantage in removing those work tests.

MR FRENEY: Perhaps in a not dissimilar vein, on page 4 of your most recent submission you address the pension and annuity requirements, and under that heading you say in the second paragraph you'd support the streamlining of requirements proposed by ARISA and go on to note that this may have some implications from a tax and social security perspective. I was just wondering whether you could elaborate on this a little please and proffer any judgments about the possible size of the impact that it might have on revenue collection. We received some interesting submissions from ARISA that, rather than trying to define products too tightly by product definition, it should be stated on a broader perspective, by product characteristics, I think, but the counter to this could well be that it's simply opening up greater opportunities to avail of tax concessions that are inherent in these products. So from that sort of policy point of view you have to be very careful of widening this way of defining products. But do you have any sense of the revenue implications, Helen?

MS MARTIN: Not really, no, and it would very much depend on the changes that you made. But certainly at the moment there's a significant industry that works very hard at getting the maximum tax advantage out of the different arrangements that

apply depending on whether you get your pension from a super fund, from a life insurer, whether you roll it over before or after you leave employment. It's incredibly complex, very difficult for members to understand, and at the moment there are opportunities for financial advisers to provide advice that allows individuals to exploit tax concessions. So there's an argument that if you simplify the requirements and make greater consistency of the tax treatment of different types of products you might actually remove some of the scope of manipulate the tax treatment.

I don't know, it depends - one of the other arguments of ARISA I guess is allowing a broader range of pension and annuity products to be treated as complying pensions. That would clearly have implications in allowing more people to access the pension RBL rather than the lump sum RBL, and of course that does have significant tax and revenue implications because you're doubling the amount of concessionally taxed superannuation that people can get. So that obviously is a concern of the government from a revenue point of view. I don't know whether John has any comments to add there.

MR MARONEY: Yes, I'd reinforce what Helen has said and just add a couple of aspects. It is a complex area to try to get that balance between having a less complex set of rules and the potential for expanded utilisation of what are continuing access to tax supported benefits and potential for behaviour to change. If it was easy to people to get those, yes, that may well be increased. I don't think the policy settings are necessarily optimal - I'm sure they're not optimal - at the moment, and I think one of the issues there is there has always been much greater concern coming from the treasury side about the tax implications and not as much concern about what the overall impact of social security access would be. A lot of people are probably making suboptimal decisions themselves at the moment because of the complexity and then being more reliant on social security benefits down the track because they didn't use their own sort of resources optimally and hence they are sort of drawing back on age pensions more quickly or to a greater extent over the rest of their lifetime.

It's hard to come up with meaningful sort of modelling on what the cost benefits would be given that it's based on changes to behaviour and lots of other things there, but I think it is an area where there needs to be some more focus on the potential benefits. If people are properly utilising their resources in a way where it's easier to actually see what the different options are, then I think there's a much greater chance of people being more financially independent in retirement and less sort of relying on the age pension than is currently the case, and it may well be just having a reduced focus on the immediate sort of tax impacts and, "Let's see if we can get a better system, and if it turns out not to be the case, the government will continue to monitor and potentially have to put sort of restrictions on there, but I'd like to see restrictions across the board rather than restrictions by product type, which then lead to all this sort of strange behaviour and whenever you change the rules there's a sort of mass shifting around which is leading to a lot of transaction costs and

others being incurred - some views to add into your pot.

MR FRENEY: I just have one other area. In our option 1 we identified a number of specific areas of trying to improve the legislation from a cost-benefit angle, and in the middle of your page 4 you say that you support these proposals to simplify, and thanks, Helen, in your opening remarks you stated this. I was wondering whether you had any views as to which are the most compelling areas or the greatest return benefit areas that we could advance in prioritising these from a cost benefit point of view for superannuation funds. Is it the ageing employment areas that cost superannuation funds and their members most dearly and should first be addressed or would you have any prioritising of these areas we've identified?

MS MARTIN: I would certainly put that one at the top of my list. Again, not so much from a cost point of view, although I think there are costs for funds in administering those requirements but more from achieving the policy aims of having people provide for their retirement by freeing up the ability for them to contribute and removing some of the artificial constraints linked to whether they're working 10 hours a week. I think that certainly has significant merit and I would advocate that be addressed sooner rather than later and I think it can be done reasonably simply and it's not difficult to change those provisions in SIS. Obviously Treasury will want to look at the revenue implications before it commits to that but I think that would be my priority.

MR FRENEY: I think our brief is not quite so wide as addressing these policy issues but it's rather more from the cost effectiveness of this legislation so I'm just wondering from that angle which of these might have the greatest cost benefits.

MS MARTIN: Looking at those four particular items that are in that first bullet point there, whilst the access for non-residents is a cost issue it's probably less significant for the majority of funds than the age and employment tests. Risk management statements, I don't think they impose huge costs on funds. Our main question in relation to those is whether they're serving any useful purpose.

MR COSGROVE: May not apply to all funds anyway, not using derivative investments.

MS MARTIN: That's right. The requirements for actuarial certificates that you're talking about I think specifically related to some particular accumulation fund arrangements and again there are some costs there and so that would probably be of those four second on my list but I would still think that the age and employment restrictions would be the biggest cost because they apply across all funds and so I would put that one first and then the actuarial certificates ones second.

MR COSGROVE: Thank you very much. Could I just clarify one point. We cited again on the basis of your earlier submission - this is on page 79 of our draft report - some reasons why you thought that the pension certification required under

modification declaration 23 should be reviewed. The third of those dot points that were from your submission stated that:

> The consequences of failing to meet the 70 per cent probability test are unclear.

On reflection, and with the benefit of some further discussion on this, would that not mean that the fund would lose its exempt status?

MS MARTIN: No.

MR COSGROVE: The member, sorry?

MS MARTIN: It potentially has an implication on the member as to whether they get access to the Social Security assets test exemption.

MR COSGROVE: Yes, but what were you driving at when you say it's unclear?

MS MARTIN: From a funds point of view, if the actuary gives a certificate that says it doesn't meet the 70 per cent probability test, it's unclear what action if any APRA would take in response to that at the moment.

MR COSGROVE: I see, okay. I think we've covered all the ground we wanted to, unless you wanted to say anything more to us. We're grateful again to you for your further assistance to us in the inquiry. Thanks very much for coming along today.

MS MARTIN: Our pleasure, thank you.

MR COSGROVE: Our next participant is the Association of Superannuation Funds of Australia and for the purpose of our transcript would you please each identify yourselves and the capacity in which you're representing the association today.

DR ANDERSON: I'm Michaela Anderson. I'm the director of publicity and research and I appear for the Association of Superannuation Funds of Australia.

MR CLARE: My name is Ross Clare. I'm principal researcher with the Association.

DR PRAGNELL: Dr Bradley Pragnell, principal policy adviser, Association of Superannuation Funds of Australia.

MR COSGROVE: Thank you and thank you once again for the further submission that you've provided to us. I guess you'd like to make some remarks about it, would you?

DR ANDERSON: Dr Pragnell will make some remarks.

MR COSGROVE: Fine.

DR PRAGNELL: ASFA appreciates this opportunity to appear before the Productivity Commission and in particular to comment on last month's draft report. ASFA supports many of the findings of the Productivity Commission draft report. In particular ASFA supports draft finding 6.1 and 6.2 that endorse continued use of the trust structure and the role for representative trustees. However, we are surprised by both the nature and direction of the review and some of its recommendations, particularly those relating to licensing and capital requirements. While security of superannuation is an important issue, we do not believe that this inquiry, given its terms of reference, is the appropriate form for this debate. If we had known that this inquiry was examining such issues we would have addressed them in greater depth when making our first submission. We believe other industry stakeholders would have as well. ASFA will however closely examine issues such as licensing and capital adequacy in the context of the options paper released by the minister for financial services and regulation on 2 October and provide our considered opinion at that time.

The draft report does contain recommendations that seek to address industry concerns over inappropriate and costly regulation, namely the complex age and employment tests for contributions and preservation, the problem of superannuation benefits for overseas workers and the preparation of risk management statements for derivatives investment. We support appropriate reforms in these areas. We agree that there is merit in further examining possible reforms for audit standards and certain issues surrounding the operation of the Superannuation Complaints Tribunal. However, the final result should come after close and detailed consultation between

government regulators and industry.

We do however reject the report's suggestion to replace the Superannuation Complaints Tribunal with an industry operation dispute resolution scheme and have outlined our reasons in our submission. We believe that any recommendation to limit the list of exempt public sector schemes must consider any constitutional issues involved in the outcome of such a limitation. We also believe that the operation of Part XXIII of SIS needs to be closer reviewed, given recent uncertainty as to how this mechanism for compensating members if triggered. Finally, we have proposed a better registration process to assist APRA in the important issue of collecting the necessary data on superannuation funds. That concludes our opening comments and I suspect we're now available for questions.

MR COSGROVE: Thank you. I think I should offer some remarks on the question raised in your submission and again in your opening statement today about the terms of reference for this inquiry. I think it's fair to say that many of our inquiries turn out to be voyages of discovery and we ourselves don't always know, for example, at the time when we release an issues paper exactly what types of topics are going to emerge during the course of the inquiry, be they raised by participants or be they matters that come up in our own minds during the course of an inquiry. However, I think if you look carefully at the terms of reference you will see that we are required under terms of reference 3 to report on appropriate arrangements for regulation which is a fairly general request made to us.

The terms of reference then go on to ask us to take into account certain matters, as we have. The preamble to the terms of reference asks us to focus, as you have noted yourselves, on those parts of the legislation that restrict competition or that impose costs or confer benefits on business, but a focus I don't think is an exclusive one. In other words, it's not telling us that we can't look at other matters and of course there are specific exclusions in the terms of reference from this inquiry which we described on page 2 of our draft report and those exclusions have I think been appropriately treated by us. But I do think there is scope within the terms of reference for us to look in this inquiry at what you might call broad matters of prudential supervision and management of funds. So I don't think we've overstepped the mark, if you might put it in those terms.

We had in the last day or so I think put to you some particular questions which we thought you might be able to help us with in a number of areas and I wonder if we could begin our discussion by looking at those. The first one related to one of the concerns you've expressed about the draft report, that is, a capital adequacy requirement, and we were wondering if you could tell us how many of your own members might be affected by the minimum capital adequacy requirement which we suggested for approved trustees and we had a notional figure as an example in the draft report of something like $2 million. If we took that as the amount involved, is it possible for you to tell us how many of your members are affected? Lying behind the question, I might say, is the thought that at least most of the large - I imagine all

of the large retail funds and many of the large corporate funds would probably already have such capital explicitly or implicitly behind them so we're trying to get a feel for the additional capital cost requirement that such a proposal would involved.

DR ANDERSON: Could I ask one question? The corporates that you're talking about who you think have capital explicitly or implicitly behind them, where do you think it's coming from?

MR COSGROVE: I imagine it could come partly from the employer's own capital base. If not it would be, I guess, coming from possibly a guarantee of some form which might again of course have to be secured against the employers' own capital. Failing that, it's presumably coming from the members. It would be drawn from money presently invested on their behalf.

DR ANDERSON: So it would be a matter of the trustee taking members' money.

MR COSGROVE: Yes.

DR ANDERSON: I'm leaving aside whether an employer would fund this. It would be a matter of the trustee upping the fees for any trustee services, corralling that money as its - that's how you see it?

MR COSGROVE: Yes, assuming that the corporation itself didn't allocate from its own balance sheet to the trustee the amount which had been set as a minimum.

DR ANDERSON: We have some concerns with that, in that that does in some way involve the employer in a way that the employer isn't currently involved. It brings back, if you like, a relationship which we would think you would want to not have there between the employer and the fund. That's one issue. We are doubtful whether the employers would want to play that role since everything that they seem to be doing is in fact to make the trust or the company fund stand on its own and pay its own costs. So having sort of gone through that, then Ross might - - -

MR COSGROVE: Of course, to be an approved trustee, which is what we are suggesting this requirement apply to, you presently need to meet a $5 million capital requirement in one way or another, okay. You either have the $5 million in your own right or you use the custodial concession as it's called. So far as non-approved trustees are concerned, all that our draft report suggested was that they have an amount of operating capital. So if you're thinking of corporate, exclusively in terms of non-approved trustee structures, then it's only working capital that we have suggested and one reason for that, I guess, only one, was that one would expect superannuation funds to have some working capital already. As I say, if not explicitly, then implicitly in terms of the in-house operation by a corporate employer who was not an approved trustee. Does that clarification help? I'm sorry, I might have thrown you off track.

DR ANDERSON: I think what we could do with is some clarification of how funds actually operate and the relationship between the trustee and the employer and in that sense, I think that's probably what we could either hear or separately document for you. It may be that we can give you some examples of that. It might be better if we did it out of this hearing in paper form.

MR COSGROVE: Yes, that would be fine but yes, bear in mind that the only additional requirement that we have proposed for the non-approved trustees is in respect of working capital and the question which we put to you a little while ago concerned I guess really - it did concern the approved trustees, that is, how many of your members who operate funds with approved trustees already have in their own right $2 million of capital NTA?

DR ANDERSON: With an approved trustee they would have to have already had capital because that's required under the approved - or the custodian.

MR COSGROVE: Exactly, yes. Now, our question is really about - leaving the custodial avenue to one side, how many have, let's say, $2 million in their own right? That's the purpose of that initial question.

DR ANDERSON: Okay. We read it slightly differently so we might actually have to come back to you on that one. In terms of working capital for non-approved trustees, going to that side first, I think it would be fair to say that the management fees that trustees take from their members of the fund is in fact what you're talking about there. There is no other source. So adequate management fees is what you're proposing. It's not usual that you would go to - nowadays anyway that you would go to the employer sponsor of a corporate fund and ask for capital. In fact they probably would not like that suggestion at all.

MR CLARE: In many circumstances the proprietary limited companies which are the trustees for the corporate funds may just be a two-dollar company. That's from my GST experiences when we were looking at them.

MR COSGROVE: We have come across some examples like that.

MR CLARE: I'm not sure - it's just some. I'd say the overall majority, many of them have never submitted tax returns. Some of them didn't have, and won't have, Australian business numbers because their only role in life is to act as trustee for the superannuation fund and basically the SIS legislation led to a greater separation from the employer. In the pre-SIS stage you could have employer sponsor companies which were also the trustees of funds and that was seen as undesirable and I think rightly so, and it's one of the difficulties if you're trying to bring the notion of implicit capital or explicit capital from the employer generally brings a greater degree of control. The proprietary limited $2 companies have equal representation on them. They have a management role. They also struggle a bit with the notion of

the working capital and what that's supposed to entail.

The 5 million for approved trustees plays a number of roles. Some of it seems to be a transitional back-up in case there is a change of trustee. How all that works I don't know. Commercial Nominees is not a good example of that provision at work. EPAS Ltd is another one where they used a custodian but the transitional arrangements have not worked well. But for a corporate fund, particularly a small corporate fund, of which there are some thousands and which they only have fund assets of 5 to $10 million and 10 members, the notion of this working capital is hard to sort of quantify. The records and their ongoing sort of working needs can be quite modest for the vast bulk of corporate funds. The larger ones - I'm wondering what the evil is that you're seeking to address, this shortage of working capital, how is it affecting - - -

MR COSGROVE: Well, it's not an evil. In the case of those very small funds with few members that you were just referring to, they would have a very low working capital requirement.

MR CLARE: So is there a problem?

MR COSGROVE: As you moved up the scale with more complex accounting and reporting obligations then, you know, we thought there was some point in having people covered against the possibility that the computer system breaks down, for example, and for a while they can't track contributions or payments or what have you. That's the sort of issue, not really an evil but the issue we were thinking about.

MR CLARE: You don't think that the assets of the fund would be available in those circumstances for remedying such problems?

MR COSGROVE: Should they be?

MR CLARE: You're suggesting that assets be taken out of the fund and put in a different pocket of the trustee to cover those contingencies.

MR COSGROVE: That's one possibility. But in the corporate sector, which is probably what we're talking about essentially here. You would also have the option of the employer itself being the source of such working capital. I mean, there are both, both options certainly.

MR CLARE: Anyway, just to get back to the numbers, in terms of the structure of ASFA's membership we have 200 corporate funds. They tend to be amongst the larger grouping. In terms of the population of the smaller corporates, say the two and a half thousand, between two and a half thousand assets under 10 million, very few if any of those would be ASFA members. In terms of the cost and time equation they generally don't become our members, though their service providers may be amongst our members and we have linkages there. So our 200 tends to be drawn from the

population of several hundred - well, it's mostly quite good coverage of the larger corporate funds.

MR COSGROVE: Ross, are these mainly corporates which do not use an approved trustee structure?

DR ANDERSON: Corporates don't use approved trustees.

MR COSGROVE: Not at all?

DR ANDERSON: Well, I can't think of a reason why they'd want to. They have in fact a representative structure which is what they're required to do under the - the only funds that have both the representative structure and the approved structure are usually industry funds that have gone public offer.

MR COSGROVE: Yes, that's what I was thinking about.

DR ANDERSON: That is in relation to the general public. It's only really funds that want to open to the general public that go for the approved trustee structure.

MR CLARE: Though I think there actually may be a few.

DR ANDERSON: There may be, yes.

MR CLARE: A few smaller corporates.

DR ANDERSON: For other reasons, yes.

MR CLARE: An alternative to using or moving over to a master trust is to hand it over to an approved trustee. APRA don't give a terribly good breakdown for their categories, but from a secondary source I've seen suggestions that the approved trustee structure has been used for some corporate funds. Again, Commercial Nominees, they were approved trustee for two corporate-like funds and again it comes down to the question of the protection that's provided to those funds. You could say there was very little provided by the approved trustees' structure and when I've been doing my analysis of fraud and losses within the Australian system, the vast bulk of losses over the last decade have been in funds which have had an approved trustee for them.

DR ANDERSON: Which has led us to believe that in fact the representative structure may in fact be worthwhile looking at, because it may be more protective. Now, if you look at the members that we have that are corporate funds without an approved trustee generally, they're the big names, the big-brand names that you see. They're the big companies that you see around town and they've got a representative structure. They don't have an approved trustee and they generally aren't getting backing from the employer. Some may, but generally they're picking up their own

costs in everything, or the members are.

MR COSGROVE: I guess it was on that latter point that I was interested and that our second question was sort of directed towards, and Ross was giving a little bit of the history of the structure of what we now know as employer sponsored funds. For those that don't actually outsource to a master trustee but which run the fund themselves essentially, I was wondering whether ASFA had any information about - those shell companies that Ross was referring to earlier actually have some substance and are able to themselves bring in a new computer system without having to rely on the resources of an employer or maybe without having to debit the accounts of members by way of having some stand-by operating capital, or that might for example have some dedicated staff whom they're funding out of their own resources, as opposed to a situation where they are relying, relatively exclusively, on either the goodwill or the resources of an employer and lying behind this question is the idea that I would have thought there could be seen to be some merit in having some resources in the entity that is running the superannuation fund separate from the employer's resources, so that's if the employer happened to run into liquidity problems then the superannuation fund would not be dependent on the employer funding it. So that was the sort of line of thinking that was lying behind the second question and I wonder whether you had any information about that?

MR FRENEY: Dr Pragnell can take that one.

DR PRAGNELL: They're calling me "doctor" because I've just been a doctor for three weeks. So there's a bit of novelty value. I haven't changed my credit card yet. In terms of contacting some ASFA members about this issue, and these are generally larger corporate superannuation funds, for the most part the expenses of the fund are generally being met by the fund, in most instances. There are some instances where the employer is providing some degree of support, but it would seem that to a certain degree there appears to be a relative strong move at that end towards funds actually covering their own costs and I think that's just the way in which these larger corporate entities have sought to deal with their expenses and so forth. So that's generally where they're coming from. Some fund staff are paid directly by the employer, but some fund staff are effectively - their expenses are covered by the fund. So there's a bit of diversity but it's probably more towards the expenses of the fund are actually being met by the fund itself.

DR ANDERSON: Can we explain a little bit about how it might work in that the growing trend is for the corporate fund to in fact hire - the trustee engages an administrator externally, so that it's making sure that your administrator has the resources and the powers and the capabilities to fix their systems. It's in the due diligence that you do about getting that administrator, which may be one of the big firms that offers this. Most of the services of the fund are more and more becoming outsourced. So the role of the trustee is much more around the notion of making sure that you engage the right people and most of ASFA's work has been around fund governance and engaging, monitoring and having in place systems for changing

these service providers. So the notion that you're - I'm trying not to say the name of a particular fund here - that you're the - you know.

MR FRENEY: Fund X.

DR ANDERSON: Fund X. You're Fund X from a big company. The notion that everything is going on within that company is probably a bit old-fashioned in thinking. What you've got is a group of trustees whose job is to manage a lot of outsourced - - -

DR PRAGNELL: And any of the staff who would be working for the fund would generally be - say you had a large corporate entity and then you had a superannuation fund, so you have the XYZ company. Then you've got the XYZ superannuation fund and you would have, say, two to three staff people who work for the XYZ superannuation fund. Those two or three people are probably not doing most of that work involving the fund. That administration would effectively be outsourced to a large provider and most of those other activities would be outsourced. They would be involved in, in a sense, acting, more coordinating the provision of the service providers, providing support to the trustees. That would be more - they wouldn't actually be sitting there, doing the data entry and issuing the cheques and doing all that.

MR FRENEY: What would be the typical practice now for the 3000-odd smaller funds that, I guess, Ross mentioned, two and a half thousand smaller members? I know back a few years that it was not untypical for effectively the employer company to be actually providing the resources for the conduct, the ongoing daily, monthly and annual conduct of the fund, and that the fund entity itself didn't have - very few if any resources to actually maintain the ongoing viability of the operations of the fund. Is there any sort of information about the general practices nowadays?

MR CLARE: As far as I can tell, again mostly from secondary sources, the funds with less than 10 million, a lot of the activity of administration would be outsourced to an accountant to the firm. When you are getting down to that size firm, if it's got 10 employees they are unlikely to have a full-time in-house accountant or financial resources. They won't have a human resource manager. You were talking about something that isn't much larger than a self-managed fund. You might have the four principals of the business, plus two or three employees, some of whom may have left the organisation. If you are talking about those entities, the in-house corporate administration, many of the associated employer sponsors may not even be corporations. Generally their financial records and accounting and are outsourced, in that they have an accountant that they go to on an intermittent basis.

In terms of the level of activity with that less than 10 members, most of whom are principals of the business and will be very long-standing members and the others not a great deal of action other than regular contributions in terms of SG or other contributions, there is not a lot of activity that goes on. There aren't the resources in

the company to do it because they are not big enough to be that specialised and quite a bit of it would be outsourced. If you talk in terms of the working capital of what is needed for less than a 10-member fund, it may be a couple of exercise books to hold the records. In terms of the accounting packages, you get them in shrink wrap at the local - - -

DR PRAGNELL: Harvey Norman.

MR CLARE: - - - Harvey Norman. If you wanted to guarantee that there was $200 in working capital available so that someone can buy a new lot of exercise books or whatever bookkeeping package, that is the sort of level of records. You may have other concerns about the degree of supervision of the outsourced activity to the accountants and I think that is where APRA would have had some experience in the past. In terms of any remedy, in terms of licensing capital levels and in-house resources for those small corporate funds, it does come down to be a little bit of a nonsense. The problems that arise with those are generally not linked to capital adequacy and transition issues; it comes down to governance where the employees not linked to the principals of the employer sponsor may get a rough deal for whatever reason or where the fund governance hasn't exercised good control and supervision of the outsourced activity. But that is a different sort of territory and I am not sure it's one that really comes down to the capital adequacy and licensing-type questions that you are looking at.

DR ANDERSON: You can see in some ways that's why we find the capital adequacy questions and the focus on that sort of taking away from some of the real issues. APRA's real concern there is that we are not delving into areas that we think may need some more delving into.

MR FRENEY: Sorry, still just on this question of having some operating capacity and capital, whether you do it in-house or whether you out-source and to whatever extent, somehow the superannuation entity needs to be funding an operation or the employer is funding an operation and I am just curious. So to take Ross's example of it being largely out-sourced, would the funding of that come through regular debiting of members accounts through some kind of administration charge?

DR ANDERSON: That's where it comes from, yes.

MR FRENEY: So there would be a through the year cash flow - - -

DR ANDERSON: Yes.

MR FRENEY: - - - into a bank account, operating account, held by the superannuation fund itself?

MR CLARE: I suspect it's more notional than that. The debiting to accounts is necessary so that if there is an exit benefit the appropriate amount is paid. How often

do you pay your accountant in those small cases is another matter. It would be a cash flow exercise for the fund. I don't think modern accounting and funds - they tend not to have separate savings accounts to pay the accountant or the administrator or whatever. In terms of the overall management of the fund, they would examine the composition of the portfolio and they would have some liquid assets available. They would have the required amount of liquid assets available, both to pay exit benefits and rollovers and also to pay the administrator and other service providers. In some ways, the leeway needed for the exit benefits is a greater liquidity concern than having the money for the administrators and the like. The latter is much more predictable and fairly easy to manage. The other can be more unpredictable and some small firms have run into liquidity problems because of difficulties in doing that, but I don't think those liquidity problems arise because they have problem paying the accountant. It would be a very tightly run organisation where they don't have enough cash to pay their contracted administration costs in the year.

MR FRENEY: There are all sorts of exposures and all sorts of risks and one of the issues that comes up is are funds adequately providing - is the framework, prudent protective framework, sufficient to cope with those risks? The participants before you were the actuaries and I asked them the question that if under the Life Insurance Act there is about $180 billion worth of superannuation money that is actually protected by a reserving requirement in the actuarial standards for all sorts of different kinds of risks like operational risk, credit risk, market risk, all those sorts of things, conceptually why is 180 billion worth of super protected that way and yet the rest of it is not? So it comes back to the question how self-contained should the superannuation entity be or how well-structured in terms of providing for these kinds of risks.

DR ANDERSON: I think if you look at funds and I'm thinking here of some large funds and some small funds that I have had to do with, I mean in a lot of instances it comes down to the setting of the administration fee so that you have appropriate working reserves for just the things that you are talking about. It may be of value to you to look at the operation of the fund to see how these things are actually done, how you do set administrative charges so that you do have adequate capital to pay for your call centres, your admins, your possible legal fees and it is very much in the framework of good governance to set the levels and to put the reserves in place to deal with the events that you know or could possibly come into play. I think you are really looking at funds planning and whether - - -

MR FRENEY: Well, that's the issue. We are all aware of circumstances where some funds have got into an awful mess because they haven't had sufficient reserve and operating capital to carry on

MR CLARE: I'm not sure. I have been doing an analysis of the funds that have failed over the last decade and the overwhelming reason for their failure was fraud or serious breaches of duty and they have generally occurred in the approved trustees as I mentioned, sometimes the other causes of failures have tended to be failures in

investments made by the fund and it comes down to a question of - or perhaps there is a possible reserving role in regard to investment. That is a rather different question and where do you put the reserves? Do you put them in the same class of investments that failed? They are the sort of problems that have been the overwhelming source of deficiencies in superannuation funds.

If you could tell us of a case where there was a superannuation fund that ran into difficulties solely because it didn't have enough working capital to deal with the administration activities or they had a computer failure and were unable to do a transition, because those funds were under the trust deed, there would generally be an ability to draw on the assets of the fund to pay for those things to fix it up.

MR FRENEY: Without naming names, I think you have put your finger on one area which has caused difficulty, which is changes in computer systems and where there has actually been enough foresight as to the cost of that and the funding of operation costs. But let me perhaps put the issue another way in a sense, like under the Banking Act and the Life Act, banks and life companies are required to have certain amounts of operating requirements. I am not an expert as to how it is expressed exactly, but at least it is recognised under those acts. The General Insurance Act I think has similar sort of provisions. So if those sort of financial institutions, the law sort of seems to think that it is a good idea that they should have explicitly these kind of requirements, why not the superannuation funds?

MR CLARE: Where does the investment risk lie with the bank and the life insurance company or a general insurance company? It is a contractual relationship where you are dealing with a company with shareholders that is for profit and they are promising you something and the regulators say and the governments say quite reasonably there should be a reasonable assurance or at least a certain assurance that those obligations will be met, that's why those adequacy provisions are in place. If you are talking about a superannuation fund and an accumulation fund, the investment risk lies with the members.

MR FRENEY: But not in the case of a defined benefit fund.

MR CLARE: With a defined benefit fund there is the actuarial oversight.

DR PRAGNELL: That's the purpose of the actuarial oversight, to ensure that in terms of assets and liabilities going forward that the fund can meet its future commitments. I mean those processes are there, they are well established, they are time honoured and they appear to work and they appear to work without necessarily imposing those additional burdens back on the funds. That's why you have the actuarial oversight, that's why it appears to work and it works in a variety of different environments, not just here, but in the overseas context as well.

MR COSGROVE: Ross, could I just come back to that remark you made about your examination of fund failures over the last decade. You said most of them are

due to either fraud or breaches of duty. You mentioned something about investment strategy at that time. Do you see that as a separate category from fraud or breaches of duty or is it interrelated?

MR CLARE: I'm not sure it's so much the investment strategy as such. At the moment you could have a look at all the major fund managers in Australia which have domestic or international portfolios. There have been negative returns. There has been a diminution of capital amongst those. That in itself isn't a bad thing and I wouldn't say that they had inappropriate portfolios. The investment risk is there and it is going to be more communicated to the members. It is part and parcel. The key features statements say in one year in 10 and one year in five you can expect this and as long as they are true to label, that isn't a problem.

The losses I am talking about are where somebody externally has taken the money and run in some shape or form. That is something that was not promised in terms of investment. At the smaller end it tends to be the accountant or adviser who has made off with the money and that has happened to a number of self-managed funds over the years. At the larger end of the thing it has been more the commercial nominees and their mushroom farms and the like. They are the sort of investment losses that I was referring to and they are losses where something has been done not true to label. I don't think they were put forward as cases where the investment adviser promised to steal some of it, though there have been a few close to that. Sometimes members have conspired with advisers to get round preservation requirements and they've used self-managed funds for that, but I'm not sure that's really the area of protection you're looking at where the member has conspired with an adviser to do a tax fraud in effect.

MR COSGROVE: The reason I asked is that my impression is that APRA's principal concern about exposure of members to loss of benefits lies in the area of poor investment choices by trustees as distinct from the categories you were referring to of straight-out fraud or failure to carry out a covenant. Do you in this study or your other experience have much that you could tell us about the problems associated with badly diversified investment portfolios or - - -

DR ANDERSON: There's only really one that's been part of media - - -

DR PRAGNELL: The Corrections Corporation.

DR ANDERSON: The Corrections Corporation, which was not fraud but seemed to be an appropriate perhaps for liquidity reasons or other reasons investment. APRA says that at the small corporate end they fear that there might be more of that. They don't actually say they know; they say they fear there might be more of that. We have suggested on a number of occasions that part of this could be fixed by better data sent to APRA. We've offered to help look at information that you might use as an indicator, if you like, of where the regulator should step in with a bit of field work and have a close look at what's going on. It may not be that you're talking

about fraud there; you're just talking about everything is in buildings instead of - it's not liquid. The Corrections example I think is a good one. ASFA's view is that a lot of those concerns (1) we don't know if they're there so APRA needs to go and look more closely, and if there is evidence of that then we'd be very happy to help with getting more data, which seems to be the answer to the problem rather than anything else.

MR CLARE: APRA has never actually asked funds for that information, but in terms of the annual returns for the small funds or indeed all of the APRA annual returns there is very little information asked about the composition of the assets or the concentration in any asset class or any particular property or share. They have the power to ask that. They do not ask it and, as I understand from their plans for the reform of the annual returns, they aren't going to get round to that until about 2003. So that's a concern to us because they say this is a problem area. They have the capacity to address it with their existing legislative framework but there seems to be a matter of priorities where they go. They do have a little more information about the larger 360 funds, because there's a quarterly statistical return where at least they have a split into asset classes and that would tell them if one of those funds had 90 per cent of its assets in property. But it just so happens that all the 360 funds I think have diversified portfolios, and that's not a concern there. In the territory where they do have concerns, they do not ask.

Getting back to the objective evidence, has much money been not available to members because of liquidity problems or asset values not being realised because of undue emphasis in the portfolios on say commercial property? There are not many documented cases, and in terms of the total losses in the system of 60 to 70 million over the last decade, a very tiny amount of that would be the sort of equivalent in that area. Again it comes back to what APRA said about the Corrective Services case, where they've indicated publicly there's no intention to do any action and there is evidence that there was some sort of employee representation in that case and there wasn't a rejection of that portfolio. In retrospect it's quite clear it was not a good portfolio. How you deal with those is another question and, as Michaela said, better information to APRA allowing the field audits and a prompting of the trustees to give evidence of an investment strategy and how it would deal with unexpected circumstances like many members leaving the fund or a downturn in the residential or commercial real estate market for those properties, that we would see as a very valuable exercise.

But in terms of remedies we would argue that many of them are available to APRA at the moment if it had the will to go down that path within its existing framework, and in terms of getting around it by licensing or capital adequacy it seems to be a rather convoluted path.

DR PRAGNELL: I mean, it's as much about finding the appropriate remedy for the problem. If the remedy is this rump of small corporates that are overexposed to commercial property, then isn't it about coming up with the appropriate supervisory,

regulatory mechanisms to actually address that issue? I think that's what we're trying to get at, that something such as licensing or capital adequacy for all APRA regulated funds appears to be a bit of a - sorry to use a cliche - a sledgehammer and walnut situation. It's about working with the regulator and trying to say, "There may be a problem here." We're not even sure. I mean, they're not even sure. That's part of the problem. There's a hunch I think in terms of the regulator that there is a problem down there, but we need better data and we need to be able to develop the tools and mechanisms to rectify those and to address that, to deal with that, rather than trying to affect the whole patient, I guess, when you only have to target small problems here and there.

DR ANDERSON: And one of the issues too that internally ASFA has looked at is if you do find inappropriate investment not diversified, all in property, whatever, it's not easy to undo that without hurting everybody. We've looked at possible ways that you might do it. We've not talked to APRA about this because they don't seem to be yet focused enough. As we said, it's probably a couple of years before they focus on this, but we would be really happy to work with them on how do you actually deal with it once you find it without hurting members of funds.

MR COSGROVE: That's an interesting point and I was wondering what you think about the desirability of earlier guidance on investment allocations, possibly even contained in the Act itself. I recall you saying that you don't like specific direction like the old 30:20 rule that used to apply and we would agree with you on that, but in rather the same way as a large sophisticated investment fund might form its own, for want of a better word, ex ante investment allocation strategy - like it's going to have a certain amount of money invested in cash, some in equities, local or foreign, some in property and so on - would you see any value in that broad kind of guidance being incorporated in the SIS Act?

DR ANDERSON: I actually think that the Tax Office does quite a good job. When a fund registers with them they send out information which sort of prods the trustee into thinking about what they're doing. In fact, I think APRA could perhaps look across at the Tax Office's way of handling small funds for a few clues on how you treat new entrants.

MR COSGROVE: But essentially information distribution rather than any sort of prescription?

DR ANDERSON: I don't know whether you want prescription, but I think it would be possible not only to send out the information at the start but when people register a new fund to actually require some evidence that they've actually read that. At the moment you have to have an investment strategy taking into account all that section 52 staff. Without being too heavy handed, you could in fact draw that to their attention and then ask them to provide some evidence. I mean, we haven't really thought this through. We're just looking at what data could you get new funds as well as existing funds to give to APRA so that it can do its job better, rather than

having legislation just letting them use the powers they have now and if need be go in and ask. You can really ask questions, "How can that strategy meet these obligations in this fund that you've just come up with?"

DR PRAGNELL: Yes. In terms of the educative nature of that, that's important. If this is the problem, like I was saying, in terms of small corporates that are overweight in commercial property, how much of that is as much a reflection of a wider societal sort of obsession with bricks and mortar? I mean, is that as much of what we're talking about? Is it merely about going in and indicating to trustees that they have to get serious about their obligations under section 62 and in terms of considering issues such as diversification and liquidity? Again, is that all we really need to do to a certain degree? If that's what we need to do, then let's come up with a strategy to bring it to attention to those trustees. These are serious issues. Just pumping it into bricks and mortar might sound good or might look good or you might feel confident about that, and at the end of the day it's not saying that commercial property or any kind of real property is necessarily a bad investment, but you must go through the process. You must consider these issues, and these are why you have to consider these issues.

MR CLARE: There isn't a large volume of new small corporate funds coming into existence.

MR COSGROVE: I know.

MR CLARE: It's more the other process of - - -

MR COSGROVE: It's more that you're working on the existing population basically.

MR CLARE: Yes. There are a few new ones, and I think sometimes it's a sort of a toss-up for the employer sponsors whether they go the self-managed fund route or they go the APRA route and have a few non-related employees in there. Sometimes it may have to do with perceptions rather than reality of how each is supervised, but there can be some concerns at the smaller end in terms of the sophistication of the investment strategy. The professionals can get a little unkind about the investment strategies of some self-managed funds because they tend to mimic the investment patterns of individual investors, which in the main are - - -

MR COSGROVE: Risk averse.

MR CLARE: I don't know about that. They tend to be fairly heavy on residential and commercial real estate, which is not necessarily risk averse, or shareholdings in just a few companies, which again is not necessarily a risk averse thing.

MR COSGROVE: No, certainly not.

MR CLARE: But it varies. Some self-managed funds are very sophisticated things. Others basically have mug punters as their members and that's just the way it is, but they're the only members, so we see it as an okay thing.

DR PRAGNELL: And there's a size issue obviously, that the greater the assets the easier it is to diversify - obviously. So if you are looking at small funds diversity does become more difficult. I mean, it's harder to swallow and increasingly obviously there are products out there that allow you to diversify more easily, but again is that merely an educative role? I mean, if it's about trustees in a small corporate saying, "We want exposure to the property market, therefore we have to go and buy a building," you can get exposure to the property market but you don't necessarily have to buy the building itself. I mean, it's educative, organic things I think that we should really be looking at as well.

MR COSGROVE: Thank you. That was helpful. Perhaps we could move to what may be an easier area. We asked you whether you would have any particular priorities in what was described in our draft report as option 1, the specific areas of the act which might be subject to amendment with a view to reducing compliance costs in particular. Did you have any thoughts on that list, pages 117 and 118, about the report?

DR PRAGNELL: In terms of looking at the three major dot points, in terms of the first one regarding the significant - simplifying certain requirements, looking at the age and employment requirements regarding contributing and preservation, restrictions on some of the overseas issues, we think that they're relatively easily rectified and we think there would be some reasonable benefits that would flow through the industry if they were addressed.

The risk management statements I think we do mention in our submission, that that is currently being examined by APRA. They are reviewing the operation of the RMSs. We are cooperating with that project. So we may end up with some improvements there as part of that organic process as well, too. In regards to the second dot point regarding increased competition among providers and the auditing and provision of actuarial services, I think our main issue there, it would be important to ensure that standards are not compromised as part of that process. As we mentioned in our submission, the current requirements appear to work. They appear to do so without necessarily generating inordinate costs back to funds and obviously if there is going to be a review of these areas that it should be done in a fully consultative fashion involving industry regulators and the appropriate professional bodies.

Some of the issues, for instance issues regarding auditor independence, are being looked at in other forms as well and, you know, we're very interested and involved in some of those discussions and think that again there is a process under way and that's worthwhile. I guess the third dot point is obviously, well, we have some serious reservations and I don't know if we would rate them in terms of - we

probably would rather see them not even in there.

MR COSGROVE: Yes, I understand. But would it be fair to say that you'd probably see the first two dash points under the first dot as where the main - - -

MR CLARE: That would be correct, yes, definitely.

DR ANDERSON: There are also areas where we have asked for some changes.

MR CLARE: Yes.

DR ANDERSON: In relation to the sort of other dot points about risk management and everything we think there's already activity going on there. So let that take place and, as you point out, we just don't like the last one.

MR FRENEY: Could I just ask Ross a question that has occurred to me with respect to the ageing employment requirements. By virtue of our terms of reference the angle that we can come from at this is the cost impact and we've thought of that and addressed that largely in terms of superannuation funds having to comply with these intricate age and employment tests, and we've heard from some administrators that it's relatively costly for them, and trustees, relatively costly. I'm just thinking from the point of view of individuals who are members of superannuation funds, would you have any sense as to whether these requirements impose costs on them as individuals, in terms for example of having to get financial advice as to what they are and are not eligible for, or what hours they do and don't have work? In other words, my thinking thus far has been quite concentrated on the impact on the costs of the superannuation funds. I was just wondering if there's an issue as well in terms of the impact of costs on individual people. Have you thought about that?

MR CLARE: We certainly get correspondence from time to time from such individuals, sometimes after they've had a rejection of contributions or an unexpected development. It's a sort of ongoing nuisance for a number of them in terms of what's involved. But if you have a look at the pattern of employment after the usual retirement ages it does tend to be concentrated more in the professional or business type area, where that advice is often sought because they have regular contact with an accountant. In terms of the quantification of the cost, it's not something I've ever seen any measures of. It's a fairly intense irritant in a reasonably small part of the membership base.

So in terms of the overall fund operations, slicing out that cost from everything else is quite difficult and in terms of the knowledge about the people it affects at the individual level that's also hard to come by. But we do have correspondence from individuals who find it a difficult area, both in terms of the complexity of the rules, the ongoing monitoring and the consequences if a bit of paper isn't done right, where they get a cheque in the mail from a fund saying, "You're retired now. Here's the money," whereas they were under the belief that they would be able to continue to

contribute. Unscrambling those situations - and, you know, it's not just the cost for the individual in terms of any ongoing advice. It's when it goes wrong and they've got to readjust their whole sort of retirement income financing plan because of the unexpected development, also have to be taken into account. But adding it up into dollar terms is - I haven't attempted that one.

DR PRAGNELL: I guess the other cost - and we haven't sought to quantify this and I don't know if anyone else has either - would be in terms of labour market participation and how people choose to interact with the labour market and to what degree these rules may have a tendency to distort what would otherwise be relatively straightforward decisions regarding whether or not you decide to continue your participation in the paid labour market. So I think that in terms of trying to create a bit of clarity and simplicity around these rules would probably help resolve some of those issues when people are, you know, in their 50s and 60s and thinking about - well, particularly in their 60s, I would say, and thinking about whether they wish to continue to work or not. I mean, it might be pretty minor and modest but I think there would be a bit of a distortion effect there.

MR COSGROVE: Would you be inclined to dispense with the employment test involved in all of this stuff or does that serve some valuable purpose?

DR ANDERSON: If you could make it over a whole year instead of just a sort of a particular period, I don't know exactly how you'd work it because I can't remember what we've said in another submission somewhere else. But certainly at different times we have come up with other ways that you might do it without necessarily doing away completely with the work test which the ATO seems to - - -

MR COSGROVE: So it's seen as serving some revenue protection purpose. Is that the way, the intent of - - -

DR ANDERSON: Yes. I think we could possibly send you a submission that we've put in there, which tries to examine who has real concerns here about the use of retirement moneys rather than estate planning and various other sorts of issues.

DR PRAGNELL: Some of those concerns flow back both from - I guess there would be tax issues but also social security and family community services obviously have had issues regarding work tests and in terms of when people can make contributions and exit benefits.

MR CLARE: We're getting down to the evil that seems to catch an awful lot of freelance clergy.

DR ANDERSON: Yes.

MR CLARE: Depending on how many funerals and locums they've done, they may or may not be able to contribute to superannuation and it could be argued that in

terms of the evils of the world, trying to crack down on the estate planning practices of retired clergymen isn't - I'd have it fairly low on the list in terms of people to harass. But they seem to be amongst the prominent victims of the current arrangements because basically the rates of employment for people over normal retirement age aren't that large and there's a few odd groups like that who keep popping up. ASFA in submissions has certainly supported the idea of super for retirement income rather than estate planning. But I think within that framework there it could be made to work better and the itinerant clergy I think should have an easier life in their mixture of retirement and part-time employment.

MR COSGROVE: You might have given us a fine quote there in our final report, Ross.

MR FRENEY: We have had some submissions, Michaela, from IFSA in particular and from some other market participants about some duplication between SIS and the Managed Investments Act and basically a proposal was coming to us that, as we included in our draft report, the possibility of deeming compliance with SIS for those responsible entities that comply with the Managed Investments Act and we're just trying to assess the merits of this idea, wondering whether you had any wisdom to give us on it.

DR ANDERSON: I think where complaints seem to be is that, particularly in the retail area, people have to comply with two different regimes. When you actually hear people nominating the area that is of real distress for them, they often point to the disclosure area, disclosure prospectuses, those sorts of areas. That now is going over to the Financial Sector Reform Act. It is still going to be potentially different for the reasons that have been outlined in that you've got different needs of consumers perhaps - well, more than perhaps. You have a different need for consumers in the compulsory super section so you will probably always have difference between that, even when they're put into the same disclosure regime in the Financial Sector Reform Act.

Our answer to that particular issue is perhaps if you have managed investment disclosure issues that you should be looking to best practice in the superannuation area where you're potentially dealing with non-sophisticated investors and you're going to try and get your disclosure documents to a state that most people can understand. So let people follow super rather than the other way around in that area, because perhaps the standard should be higher there. Now, having said that, I think to answer that question you'd have to look even further at what's happened with the Financial Sector Reform Bill anyway and sort of how much closer that has been.

There probably might be some merit in looking at SIS and Managed Investments Act in relation to some areas and seeing whether in fact the higher standards in one or the other need to be duplicated in the other. I mean, you might sort of look at that. But we wouldn't necessarily - I think that would need some considerable industry consultation to do that and I think you'd probably, at this point,

want to let the Financial Sector Reform Bill, which is trying to, in some of these areas, bring in a consistent regime, settle down before you started to fiddle with any more changes to the system. I think the Financial Sector Reform Bill does in some areas try to look at consistency and one area, for example, is the cooling-off period which superannuation funds have always had, managed investments didn't.

Now they're all going to have it. So the Financial Sector Reform Bill - Act now - is actually going to impact on this. I think you let things settle and then look again to see whether there's any need to bring in line various provisions.

DR PRAGNELL: Yes, I think the cooling-off period is a very good example in terms of feedback that we have traditionally got from our members who provide both managed investments and public office superannuation products. It was a difficult issue that had problems in terms of coping with staff training and preparation of documents and systems and so forth, because you had a cooling-off period for one type of product and you didn't have a cooling-off period for another type of product. Now that is standardised, so those types of reforms are happening already. FSR in terms of licensing will also bring across some of what MIA does as well too.

For instance MIA requires - and this is through asset policy statements - compliance committees for instance and the various compliance structures. A lot of that is now brought across into FSR licensing and will affect those superannuation funds that will be licensed under FSR. So it is happening under FSR to a certain degree. Some of these issues are being addressed, I mean in terms of the feedback that we have got from our members.

MR FRENEY: The other question in this area is basically for superannuation moneys that are going into the statutory funds of life insurance companies. In essence could the Life Insurance Act be sufficient protection from the prudent management side of things and obviate the need for insurance companies to have to comply with SIS requirements, other than retirement income and revenue sort of protection? I wonder whether you have a feeling about that?

DR ANDERSON: We did have some discussions on just this issue.

MR CLARE: In terms of what is supervised and what it is fair to supervise, the issue has come up in the context of both the review of the levies paid by superannuation funds and other supervised entities, in terms of the setting of those levies. So there is a bit of a background. At the moment there is quite a bit of superannuation business which isn't supervised within the SIS framework. Annuities and certain other products which are directly written by life companies and relate to the statutory funds are basically regulated under the Life Insurance Act, so there isn't that duplication made.

Where you have a trust structure which is operated by a life company and those funds which are gathered through that structure invested somewhere else, it could be

argued it's entirely appropriate to deal with the supervision at each point where it is appropriate. The life company may put it in the pooled superannuation trust, which are supervised entities, they may put it in a bank account which is supervised under another leg of APRA's powers, or it may go into the life office statutory funds. But there is something that has to be supervised in terms of the superannuation trust and how it deals with money, how it might have a policy committee, how it might have an investment strategy; all those things which come with SIS in addition to the retirement income-type constraints of the government.

When it moves somewhere else and we have argued in the levy context it's entirely appropriate that it be supervised where it is going as well and that the levy costs reflect that. In terms of the way the life companies are structured, because of the way the system works, they do have separate hats and the modern life company has a whole range of activities. Some of them have banking activities, they will have the sort of life policy, but 80 per cent of their business is superannuation related business. Some of it is directly on the statutory fund, some of it isn't and I expect John Maroney earlier today would have gone through those issues in a better way than I ever could, but there is a certain logic into the different sets of legislation relating to specific activities.

The fact that a bank for instance, as far as I'm aware the four major banks all have different arms now. They have life companies, they have superannuation trusts, they have banking business, some of them do general insurance. I know APRA is rather fond of their conglomerate approach and everything is really the same, but the law isn't. There are separate Acts, there are separate responsibilities, there are separate groups of customers in each case. So while those differences remain, it could be argued that separate supervision is entirely appropriate. That's the way the world is, rather than a different world which we don't have.

MR FRENEY: It is interesting we received representations from Phillips Fox Consulting Actuaries that the trust structure in regulated entities of life insurance companies sometimes at least didn't really contribute very much to the overall management of the superannuation funds and to all intents could be got rid of and you could do that by relieving the life companies from the need of having to comply with the SIS Act. Having said that, when we spoke informally with some life companies, they tended to say that they would keep the trust structure, because it does actually provide a structure for making decisions and handling issues. The impression they left with me was that the cost savings would not be all that great in terms of removing the SIS Act, because under the SIS Act they can sell group life policies, which when the superannuation contributions are coming in and that is a far, far cheaper process than if you were having to sell them to individuals and you were not bringing the money in through a trust structure. So it didn't have any clear cut cost impact that I produce anyway in these discussions.

MR CLARE: These days the trust structure in using other parties for investment or at least having that option is a market advantage. Life companies that do everything

themselves and do everything through the statutory fund may save some administration costs, but they wouldn't get any share of the market. They used to do that and there are some of those residual products still around, because of the exit fees and the sort of investor inertia. But that isn't the marketing model of the modern life company. I think your informal feedback would confirm that. If they did go back to that old model with everything through the statutory fund, they would have basically a dog of a product.

It might be simpler in some ways and perhaps cheaper to administer, but that model has been tried and it has failed. It is a very old-fashioned model and in terms of what people are looking for and flexibility, it doesn't deliver what the market demands. So it is a little bit of an illusory goal I think. The industry used to be like that and perhaps some notions were affected by it and the actuaries tend to be a bit more familiar with the statutory fund and that sort of mechanism and comfortable with it. I think the world has moved on.

MR FRENEY: I don't think I have picked up where you have come out on this question as to whether, say, the moneys going into the stat funds of the life companies need not be subject to SIS. Have you got a - - -

MR CLARE: I think the moneys in the life company statutory funds are subject to APRA's supervision. The SIS surveillance of them is not great I would have thought. It is just one part of their investment portfolio. The SIS obligations are more in regard to the trust structure that is in place and I don't see how that can be removed, because all or some of the funds are going into the statutory fund. It is all going into the statutory fund in every case. I'm not sure why you would have a trust structure in place.

MR FRENEY: I think that was one of the points with Phillips Fox, you leave it to the directors of the life insurance company.

MR CLARE: Well, they have that choice at the moment.

MR FRENEY: They do with respect with some products - - -

MR CLARE: They would write it directly and some of the old style life policies, they are basically structured to the superannuation for tax purposes, but they are run through the statutory fund. I am not sure if many of them are actually sold any more, because they are not attractive in the market. As I understand it, they are basically regulated under the Life Act, the big and growing area of the life company business, particularly in regard to the new businesses through the trust structure and that's the direction they are going.

MR FRENEY: So you would see it as having some merit in retaining a trust structure?

DR ANDERSON: Yes.

DR PRAGNELL: Yes, definitely.

MR CLARE: Yes. It is a market advantage for it I think, gives protections and if there are not some non-statutory fund investments, I think it is unavoidable to regulate the entity that is making those decisions. If everything goes into the statutory fund, in the circumstances I'm no sure why they would have ever had a trust structure in place. That sort of business they write, using other mechanisms, tends to reduce the problem down to a nil set basically. I'm not sure where this duplication is occurring.

MR FRENEY: Thank you very much.

MR COSGROVE: There are two aspects of your current submission to us that I would like to clarify. The first is on page 5 and it relates to your discussion of superannuation contributions in respect of foreign nationals and superannuation benefits of people permanently departing Australia. In that box indicating your position on the former, you say that there should be no requirement for the superannuation guarantee contributions in respect of foreign nationals working temporarily in Australia if they are remunerated by their home employer. That is okay. So they are foreign nationals working temporarily in Australia.

DR PRAGNELL: Who are being remunerated - - -

MR COSGROVE: Then the next sentence under the next section talks about your acceptance that foreign nationals on working holidays should be subject - so the difference is that the latter group are not being remunerated?

DR PRAGNELL: Yes, and we are looking at two different sets of foreign nationals.

DR ANDERSON: If you are talking about costs as you were with that earlier one about working periods, then the amount of time and money that firms and consultants, large consultants, seem to spend in this area of looking at how to pay people who come here for a while, in my own fairly limited experience seems to be quite huge in that this area of paying people to work in Australia or paying Australians to work overseas seems to get a hell of a lot of consultant activity around it just to work it out.

MR COSGROVE: The second one concerns the exempt public sector schemes. At the top of page 7 you refer to possible constitutional difficulties. I take it by constitution you mean the balance of powers between the Commonwealth and the state government?

DR PRAGNELL: Yes.

MR COSGROVE: But then you also say that our recommendation amounts to a proposed ban on providing a corporate superannuation scheme. I didn't quite follow why you had reached that conclusion. We did say that any new schemes should merely be subject to the SIS Act.

DR ANDERSON: But I don't think - well, we're not constitutional lawyers but we didn't actually think that they could be.

DR PRAGNELL: Yes, they may not be able to - - -

MR COSGROVE: Because of the constitutional problem?

DR ANDERSON: A state scheme under a state act I don't think can be subject to SIS. I mean, we were actually cautioning here, I think, that you should check that out. We think that's why they're exempt and brought in under an agreement between the states. I mean, that's our understanding of it.

MR COSGROVE: Thank you. We'll look again at that. I vaguely recall that some state schemes do comply with SIS.

MR CLARE: They elect to.

MR COSGROVE: They elect to, yes.

DR ANDERSON: But they can only elect to. I mean, that's the point. I don't think you can require them.

MR COSGROVE: You can't make them. You can't force that upon them. Yes, I see what you're saying.

DR PRAGNELL: Yes, we don't want to necessarily restrict the ability of state governments to offer new superannuation arrangements merely because the list is basically frozen.

MR COSGROVE: That's helpful, thank you. The final question is one that Michaela referred to briefly in our earlier discussion and that is you thought there might be some greater sense in what you called a registration process rather than a licensing arrangement and the earlier reference - I remember you suggesting that a possible part of such registration might be that superannuation trustees had actually looked carefully at the ATO guidance on investment allocation so that they knew what they were getting into. Have you thought at all - and I realise what you had to say in your opening remarks about all of this - about what else might form part of a registration requirement, if anything, other than signing a form saying, "I'm registering as a superannuation fund with APRA"?

DR ANDERSON: This is not ASFA's position at the moment but we have actually been looking at what kind of information could you require or even what kind of declaration could you require. For example, would you require the trustees or the directors of a corporate trustee to actually declare at that point that they weren't disqualified people? Could you require them to say that they had set up separate bank accounts from the employer or any other - I mean, those sorts of things where you would actually, within the registration process, ask them to provide information in a specific form about various areas. What those areas might be we haven't concluded yet but certainly we're doing some work there to see whether you could give APRA some early indications so they don't have to wait a year. Tied in with this is that APRA should be looking at improved additional information annually and perhaps at the very start. The two things would go together and they need to be looked at together perhaps too.

MR COSGROVE: Accepting that you haven't reached a position on all this yet, if you look at what we had suggested as possible examples of what we call licensing conditions on trustees - now, I understand that you don't like the operating capital suggestion except perhaps insofar as you think it's already covered by management fees, but we also indicated the trustee should show a capacity to actually manage a fund; that they have an investment strategy. That's, you know, getting a bit like what you were suggesting in a milder form earlier, using independent auditors, having an approved dispute resolution arrangement - yes, CCT is another issue where you would say that's already in place.

DR ANDERSON: Yes. I mean, I think you could possibly go through the SIS Act which heavily prescribes how trustees should and could act and from that take out items. When you look at the capacity to do the job, I'm not quite sure what you mean by that but you could actually get them to document what they've got in place to do the job.

MR COSGROVE: Yes, or show some relevant experience - - -

DR ANDERSON: I don't know that I would get to the individual level at that point. I would just ask them how they're going to do the job. For example, have they got separate bank accounts from themselves, the employer and those sorts of things so they can tick off the box. Have they - I'm just trying to think of the little list that I'm composing but it's actually about how they're going to behave as trustees rather than they themselves, other than the fact that yes, they might tick off that they're read the trust deed. They've read and they're aware of the fact that they are in control of the show, however you like to express that. Those sorts of things, and then how they're going to conduct the business. You may have a check list there and as I said, part of my thinking is actually going back to the check list that the ATO uses as a check list - it's not sent back to the ATO as far as I can see - but it's a self-assessment check list. That might be a useful sort of starting point for APRA to consider in its dealings with other funds.

MR CLARE: Just getting back to my historical analysis of where money has gone astray, APRA asked the question about what qualifications you have and if a trustee nominated the history of financial advice and entrepreneurial deals and financial dealings, I would sort of use that as a tag for high risk category. The amateur trustees and processes of good fund governance which are the equal representation, setting up separate bank accounts and having in place the right systems and what you're looking for and to be frank, if you look at the investment professionals, they have been more part of the problem than the solution in the governance of both small and large funds. That's funds which have good fund governance and good systems in place generally don't go astray. Those which have strong-willed individuals with a history of financial dealings and faith in their own abilities have been the ones that have gone astray.

I take a rather different twist on those questions and the answers and I would put some of them on the high-risk category where they claim to have the requisite knowledge. I wouldn't necessarily condemn anyone who has been to the Securities Institute or undertaken the ASFA entry level courses and the like.

DR PRAGNELL: We strongly encourage people to do that.

MR CLARE: Yes, that gives them the good fund governance amongst other things but I think you have to be wary of some of these so-called qualifications and background to be a good trustee.

DR PRAGNELL: And I think in terms of some of Ross's work, what we've found is that member representative trustees have actually formed an important component of in a sense providing good fund governance. They've actually acted as that counterweight, part of the checks and balances. Some of those individuals may not necessarily have graduate diplomas from the Securities Institute or other high-minded qualifications but hopefully it would appear that they are asking the right questions and I think that's as much as you can ask from any trustee or any director, the ability to ask the right questions.

MR FRENEY: I guess I just have one other question, if you could bear with me. In our draft report in option 4 we briefly addressed an alternative legislative model which has been commonly compared to the General Insurance Act and the Banking Act with the three tiers and I think might have been included in the options paper that Mr Hockey released as a possibility and that's a model that APRA has been mentioning publicly. I was just wondering whether you had any views about this.

MR CLARE: This may be one to take on notice.

MR FRENEY: If I could just ask a subsidiary question, that one of the ways in which this approach might need to encompass is that you would separate out the prudent management objectives of SIS and then apply the General Insurance Act type model to a streamlined or a focused SIS and then you'd have separate legislation

relating to retirement incomes objectives and revenue protection objectives and for example they could get built into the Income Tax Assessment Act. There are proponents of this model. We did hear from some trustees that trustees rather like to have all of their responsibilities and commitments encompassed in one piece of legislation that they can have by their elbow at their board meetings and that the downside to this model, where you carve up the obligations of trustees under different acts was a downside to it. I was just wondering whether you've heard that.

DR ANDERSON: Yes, we refer to it as the fragmentation of the Bible and this is really what is happening, in that you've got - SIS, one of its merits was that it was the one bit of legislation outside of parts of tax that you could deal with. I think there was merit in that for trustees and for their advisers. Recently something else passed by my desk in ASFA which was referring to the fact that trustees now would all have to have copies of Corporations Law with them as well and that sort of horrified several people, to think that you've now got sort of to find the right bit of the Corporations Law. Undoubtedly some publisher will come up with, you know, all the bits of law you would ever need to know to run your fund, sort of thing, but if this is going down that path where you will have more fragmentation I think we would caution.

I also think underlying all of this too - and I know we've now got sort of consumer issues on one bit of legislation and prudential issues in the other. I really question whether you can make that divide in superannuation under trust law in such a very clear and simple way. It may be, you know, it's too late now to go back and revisit that but I also think we would need to look very carefully if we're trying to pick out retirement income policy versus prudential issues or sort of make that distinction too. Whenever we do that we tend to end up with a potential for duplication as well as confusion and fragmentation.

DR PRAGNELL: When SIS was carved up as part of Wallis in terms of assigning sections to various regulators, some of it appears I think from the industry point of view to be somewhat arbitrary. For instance, the requirement regarding minutes of trustee minutes, the responsibility of that to rest with ASIC rather than with APRA. I know that some trustees and some service providers expressed concern about that at the time when that was done because they felt that it actually was more of a prudential issue but it was felt obviously on high that it was more of a consumer protection issue so you do end up occasionally with - when you have this carving up of SIS, when you have it being carved up between the regulators and now you have a more formal carve-up, it does create some uncertainty and some concern, I think.

DR ANDERSON: Looking at what you've got here though, you're actually looking at carving up this way, which is sort of - the Act is very brief.

MR FRENEY: Both ways actually but yes, that's another topic and please talk about it, yes.

DR ANDERSON: The Act is very brief. APRA has a hell of a lot of power and you've got guidelines somewhere in there. I don't know where they come from, from this. The second dot point where you actually ask APRA to issue plain English flexible disallowable instruments, I'm not quite sure that I understand the structure there, where it's a disallowable instrument by part of the regulation but APRA has - presumably it's regulation that that's referring to?

MR COSGROVE: Well, it could also I think encompass some existing pieces of the Act.

DR ANDERSON: But by way of regulation so you're talking about - - -

MR COSGROVE: Yes.

DR ANDERSON: You're talking about more regulation and less of the Act.

MR COSGROVE: Less law, correct.

DR ANDERSON: Yes.

MR COSGROVE: Although the standards would be disallowable instruments so that if - - -

DR ANDERSON: Yes, but that's pretty much what you've got now in some ways. I mean, the regulations to SIS are vast because that's where all the operating standards are but most of those operating standards are a mixture of both prudential and retirement income policy standards. I think it would be very difficult to try and put anything to remove what's in the Act and what's now in regulation.

MR FRENEY: I think effectively that APRA is proposing a very, very different beast, legislative framework, than what SIS is now. It's envisaging that you would have a relatively short and high order sort of act that stated some very broad objectives basically, as does the Banking Act now and the General Insurance Act, and then goes down to two other tiers, one of which we might think is more in terms of setting regulations.

But the real difference I think is with respect to APRA being given the authority to have standard-setting powers which it would be allowed to design and implement through the course of time and be able to do it themselves and then submit those to parliament for parliamentary scrutiny. But it could allow a far more active and responsible APRA in terms of dealing with industry evolution than is now possible for it under the current SIS Act. So rather than having a very rigid sort of framework where it's black and white law that APRA's powers are very clearly defined and trustees know exactly where they stand, you'd have a very different sort of scenario of flexibility in the law with respect to APRA's powers. So I was just wondering whether you had any views about that.

DR ANDERSON: We do have some concerns about APRA and its abilities. I think that would be top of our list. We would probably need to see APRA perform better before we would want it to be given more powers. It's probably as simple as that. We have made that statement previously, so that worries us, although the notion of using disallowable instruments rather than law is something that we're not - we think quite kindly of that in other areas and it sounds as if the disallowable instrument which turns into regulation in effect is probably safer than if they had just given powers to make policies which are enforceable without having to go back the parliament.

MR COSGROVE: Be accountable, yes.

DR ANDERSON: Yes. I mean, wider than ASFA, but there has been some concern about the powers that ASIC had in some areas which didn't actually have to go back through the parliament, and so I know there is sort of a wider concern there about the powers that you do give the regulator without any accountability back through the parliament and without necessarily requiring any real consultation with industry. So the balance between flexibility and fear of the regulator I think has to be - - -

MR CLARE: And it would be unfortunate if a change in the legislative structure distracted from some of the tasks at hand, where it could be argued that APRA does have powers under its existing provisions but hasn't always exercised them or hasn't always exercised them well. That's part of the question: is it the framework or is it the exercise of the powers. I think on that decision the jury is out and there are certainly different opinions. APRA has a different opinion to others but it is a question of accountability for what they've been doing and certainly many have suggested they could lift their game in a few areas. We've already talked about some of the information gathering areas where they do have the power to specify what information is to be supplied. You don't need a new legislative framework to do that.

MR COSGROVE: I think, to be fair to the proposal, it does have in mind some other objectives, like being able to respond more quickly as circumstances in the industry change rather than having to fight your way through the House of Representatives and the Senate to catch up.

DR ANDERSON: If the second dot point was in fact not "may be disallowable instruments in parliament - - -"

MR COSGROVE: It should be.

DRANDERSON: It should be - or was actually through that process, that - - -

MR COSGROVE: You would feel a little more comfortable.

DR ANDERSON: We would feel much more comfortable.

MR COSGROVE: Tell me, I should know the answer to this myself, but what happens with such a disallowable instrument? Does the proposed standard not go into effect until it has been subject to parliamentary scrutiny or does it go into effect and then can be overturned? We can find out in Canberra, I'm sure, but - - -

DR ANDERSON: The only thing I know for certain - I'm trying to think back to my days in this area - the parliament can't amend it in any way. They can throw the whole thing out or that's it, but it has to be gazetted and it has so many days, a certain period of time, before it actually can - - -

MR COSGROVE: Before it comes into force, I see.

DR ANDERSON: Yes. But I think the appropriate people should be asked, yes.

MR FRENEY: Thank you very much.

MR COSGROVE: We've had a lengthy discussion and you've given us some food for thought. Thank you all for that. We'll break now for lunch and we're resuming at 2 pm.

(Luncheon adjournment)

MR COSGROVE: We'll resume now with our next participant, which is the Small Independent Superannuation Funds Association Ltd. Would each of you please identify yourselves for the transcript.

MR LORIMER: My name is Michael Lorimer. I'm a director of SISFA as well as the chair of its policy development committee.

MR McDOUGALL: Graeme McDougall, the chief executive officer of the Association.

MR COSGROVE: Thanks very much. Thank you for a further submission to this inquiry. You'd like to speak to it, I guess.

MR LORIMER: Thank you. We'll just make some brief opening remarks, if we may. Firstly, SISFA welcomes the opportunity to participate further in the Commission's inquiry. You'll note from our submission that we've effectively limited our comments to the two options identified by the Commission and recommended by the Commission involving modifications to the SIS legislation, option 1 and option 2, and we'll talk to those in some more detail shortly. Aside from those specific areas, we would like to emphasise the fact that we still remain committed to our longstanding position that our superannuation system as a whole requires a lot of review and reform and we've made comments in the past that it is difficult to look at these sorts of aspects in isolation with any reasonable prospects of long-term improvements, bearing in mind the interaction of our super system with income tax and social security type issues. In that regard we're also pleased to note that the Commission made similar observations in the overview section of the paper, so we would emphatically endorse that position .

On the specific options identified and recommended by the Commission, SISFA would suggest that the areas that should be given priority are the simplification of the age and employment requirements relating to contributor status. The contributions acceptance rules in particular should be amended on the basis that there are some obvious inequities and anomalies in the current regime, aside from the complexities involved. Specifically in that regard we'd draw the Commission's attention to our detailed analysis of our proposed amendments in our original submission of May of this year. We remain committed to that position.

The other specific area and option 1 is dealing with the current restrictions on the transfer of super benefits of genuine non-resident short-term employees or people who are genuinely permanently departing for residence overseas and are trying to ensure that those sorts of super benefits are portable in some way, shape or form. Why we think those specific areas can be given some priority aside from our position on the need for an overall reform or review of superannuation is that we think that either or both of those areas could be amended relatively easily without detracting from the overall interaction of super with income tax and social security. We think they can probably be quite simply and successfully dealt with in isolation without

affecting any long-term objectives.

Further under option 1, we were interested to see the Commission's observations in relation to a potential review of the carving out, if I can put it that way, the compliance audit aspect of superannuation funds. In that regard you'd obviously be aware of the significant progress that has been made on audits or approved auditors generally speaking by the Senate Select Committee on Superannuation and Financial Services, which has obviously covered things like audit independence and all sorts of things. SISFA expresses its interest to be involved in any further debate in that particular aspect. For present purposes we would be concerned that any carving out of a component of the overall audit of a fund, if I can use Brad Pragnell's comments from ASFA earlier, may involve a risk of compromising the current standards. We're not too sure how a separate compliance audit function would relate to the other audit aspects in terms of overall accountability and those sorts of issues, and it may well also involve additional costs. So, without having a final position on that particular issue, we'd have some concerns that that might detract or in fact dilute the role of the current audit function of superannuation funds generally.

Turning to option 2 identified by the Commission and the effective introduction of some form of a licensing regime, once again we'd reserve our final position on that specific aspect, principally because it's also being dealt with in a lot of detail under the issues paper released by the Minister for Financial Services and Regulations earlier this month, which we will be participating actively in. We'd just like to make sure there's no duplication of review issues there.

Be that as it may, at this stage we're not convinced that a licensing regime is necessary or indeed that it will have any real improvement on the existing arrangements. Really the reason for that initial position is that we're not convinced that a number of the so-called small funds that APRA have identified as being higher risk type of entities from a prudential supervision perspective really do require the extent of prudential supervision that is currently contemplated. The reason we say that - and just coming back to a few remarks which ASFA made previously, which we've also referred to in our submission - there is insufficient data in the marketplace in respect of the composition or make-up of those funds to support the perceived need for the licensing of those particular entities where they don't have approved trustees. The data isn't there to support that proposition. It's anecdotal. It's a feeling more than anything, and what we'd like to see obviously is an immediate and suitable quantitative analysis of those particular entities before I go into the next stage of looking at any form of licensing regime.

In particular we're of the view that a number of those particular funds may in fact be more in the nature of self-managed funds but they come under APRA's supervision simply because they have five or more members. A number of those funds may in fact be five or six-member superannuation funds where all of the members are related to each other through business or blood and really

fundamentally in nature are no different to a self-managed fund save for the number of their members. Our question in that regard is therefore whether or not those sorts of funds really should be subject to the same extent of prudential supervision as a fund with 5000 arm's-length employees, for example, which is currently the case.

So specifically we'd like to see the data gathered to quantify the need or otherwise for any form of licensing and until that data is available we don't consider that any progress really will be made in that regard as the nature of the funds isn't really known. Overall we're more committed to the notion that education of trustees and more efficient enforcement of the existing regulations and provisions are required than the introduction of perhaps another layer of regulatory requirements.

Just as a couple of closing observations, which we've also referred to in our submission in respect of the specific licensing proposal, we do make the observation that of the most recent notable superannuation fund failures most of them or all of them have involved in fact APRA-approved trustees, which are the licensed entities. And that observation has also been made by ASFA earlier. So on that basis we're sort of questioning whether or not any more licensing is going to achieve any improvements on the basis that there's a fairly comprehensive licensing regime in place at the moment and that seems to be where the collapses have occurred.

We'd also, if there is any progress whatsoever made on the licensing proposal, we'd just be concerned to ensure that there's no unnecessary overlap with any trustees' obligations under their potential new licensing requirements following the financial services reform amendments. That's pretty much all I have to say. Graeme, did you have anything to add at the outset or - - -

MR McDOUGALL: I'd just like to expand a little bit if I might just in regard to that point that Michael has raised in regard to factual information because I think it's really a very, very important issue. And if I may with your indulgence just step back a bit, a couple of years ago we had the changes brought about by what was commonly known as SLAB 3 and SLAB 4. They were brought about on the basis of anecdotal evidence on perceived problems, and we saw legislation changed on those perceptions. It's interesting to note that at the time there was 142,000 self-managed or let's say excluded funds out there, which were the small funds. To the best of our knowledge there's been two prosecutions since for 142,000 funds, which one could say that the perceived problem hardly existed.

Just to reinforce Michael's point and I think also would be reinforcing what ASFA said this morning, we really don't know what the degree of this perceived problem that requires licensing is about. Can I just refer to an important notice that was put out by APRA recently in regard to their statistics for the June quarter of 2000. It said:

> The assumptions behind superannuation trends have been revised. With this issue of the superannuation trends including historical adjustments, the aim in reviewing the methodology behind superannuation trends was to improve the accuracy of statistical estimates and incorporate self-managed funds data from the ATO.

Now, I think that in itself is even saying, "Look, the work that we've done in the past in relation to what is the stats that we've been producing has been wrong and has had some problems," and we're still living with this problem that again they're perceiving there is a problem. I've asked the question, "How many funds of the small corporate fund sector, which is supposedly the group that have the problems, how many of those do not have arms-length members?" The answer I receive is, "We don't know." The next question is, "Why don't you know?" The answer is, "We don't ask the questions."

So I find it difficult that we're being asked to support the notion of a new regime of licensed trustees, again on the grounds that there's a perceived problem, and I just reinforce Michael's comments in relation to factual history and it tells us where the problems have been in the funds that have had problems and none of them that we can find relate to small funds. But they tend to be in the best of our knowledge all involved with people with funds that have actually had professional trustees.

So is there a perceived problem in, what should we say, volunteer trustees? We certainly can't see that, and on that basis maybe if the problem is that there are too many funds for APRA to administer, particularly in this small corporate sector, then one of the reasons which Michael has outlined is probably to say, well, until we know how many funds don't have arms-length members, maybe we can look at the problem and say, well, if we move them from the small fund sector if there's a large number, because of the number factor that could become self-managed funds, then we could be resolving a problem without the trauma of going through a situation of introducing a new regime under licensed trustees. So I'd just like to leave my comments at that.

MR COSGROVE: Thank you. Well, we might work through your submission to us sequentially. So far as option 1 is concerned, you seem to be essentially agreeing with a couple of our proposals. I have though two further questions of my own in relation to those proposals. The first is whether in respect of the requirements governing contributions you see any continuing role for the employment test criterion there. We have age-based differences and then there are different employment tests applied according to the age group. Do you see the latter as being an essential part of that system?

MR LORIMER: In that particular respect, and just referring back for a moment to our original submission on that view, we felt that there still remained a place for a - - -

MR COSGROVE: I'm sorry I hadn't gone back to that.

MR LORIMER: No, that's quite all right. I pre-empted the question being raised. We think that the employment relationship may remain a factor for those people who are in the aged 65 to 70 or 70 and over age group but up to age 65 we're questioning whether it has any relevance whatsoever, particularly on the basis that that, by removing it from one of the requirements, would achieve consistency with the current eligible spouse contribution regime where, for example, a married couple at the moment where both parties are currently unemployed but under the age of 65 can make voluntary contributions on behalf of each other to a super fund but a single unemployed person who hasn't been employed in that situation can't. So up to age 65 we would support the employment test being relaxed or removed - - -

MR COSGROVE: I see, it's bringing consistency, yes.

MR LORIMER: - - - but then after 65 to 70 in light of the - after age 65 or after age 70 as the case may be, to retain some requirement for a nexus with the workforce, principally to tie in with the rules relating to the cash-in of benefits, which is consistent with the, you know, sole purpose test issues and may in fact deal with that concern about possible - the so-called estate planning argument and those sorts of things.

MR COSGROVE: Yes, I remember Graeme making that point earlier, yes.

MR LORIMER: So in other words if you still retain - if you're still in the workforce you should still be able to make voluntary contributions on the basis that you haven't retired yet, and until you retire in the true sense of the word that's when the compulsory cash-in requirements come in and the benefits must be converted to a lump sum or some sort of income stream.

MR COSGROVE: And that's the basis on which you feel any implications for taxation revenue would be covered, yes?

MR LORIMER: Yes. In other words there's always going to be a trigger that requires the benefits to be converted into some form of non-super money or put to retirement purposes. You can't keep indefinitely deferring it, it's impossible. The regime at the moment, contrary to any perhaps express concerns that in the absence of an upper age limit there might be some estate planning type issues relating to super as opposed to retirement income type issues. Our view is that the current regime can't allow that indefinite deferral. There has to be a point in time where the benefits are converted into a lump sum or retirement income stream.

MR COSGROVE: I'm not as knowledgeable in this area as I probably should be but I can see that clearly being a distinct possibility with a set of accumulated benefits during a person's working lifetime. What about the possible situation in

which somebody let's say, aged over 65, starts making new contributions to superannuation with no real intention of drawing any retirement benefits from them but simply, to use the jargon, "for estate planning purposes". Is that still possible under your understanding of the system?

MR LORIMER: Well, if we have a look at the current system, somebody who's over age 65 but under age 70 to make a contribution must be at least in regular part-time employment for 10 hours a week.

MR COSGROVE: Yes.

MR LORIMER: They can't make a contribution unless they satisfy that requirement. Now, after age 70 you can't make voluntary contributions full stop. So someone in that situation would have a five-year window to do so and then once again, after age 70, if we then look at the compulsory cash-in requirements, after age 70 to keep moneys in the superannuation environment you must maintain full-time employment status of 30 hours or more a week. If you don't satisfy that requirement the trustee of the fund must convert the benefits into a lump sum or an income stream.

MR COSGROVE: You think that's fairly tight control.

MR LORIMER: It is. I mean, it brings in this argument, this so-called policing of the compulsory cash-in requirements issue into the debate where there's been comments made that some large superannuation funds, you know, monitor people over the age 65 in terms of their employment status on a monthly basis or six-monthly or whatever it is, and that for the purposes of the regulations it just simply says that the trustees must make reasonable efforts to satisfy themselves that they're still able to keep the benefits in the system. So there's perhaps some clarification or improvements to that policing aspect that could be made.

MR COSGROVE: Yes.

MR LORIMER: Having said that, perhaps it's not an unreasonable proposition to just have it as an annual type of an issue on the basis that it does form one of the standards that the auditor must cover at the end of year. So as a matter of course any approved auditor would have to have a look at all of the people in a fund who are over the age of 65 to ensure that the trustee had established what their employment criteria were. Our position basically remains that we think that the compulsory cash-in restrictions that are currently set out in the SIS regulations negate effectively the need to have an upper age limit for the contribution side of things. We believe that they're tight enough to ensure that this estate planning concern is adequately dealt with.

MR COSGROVE: Yes, thank you. Do you have anything that you want to ask?

MR FRENEY: Yes, just in that area I'll just ask the question, because you can think about this perhaps as we have a little bit just in our discussion from a policy sort of point of view and the merits of promoting superannuation contributions as a retirement income policy objective. It might be a little bit broad of our terms of reference and our term of reference is to assess the cost benefit merits of the SIS Act.

I was just wondering from the point of view of your constituency it's not quite as clear to me that these requirements actually would have a significant cost sort of impact on the kinds of funds that you're representing as compared to some of the larger industry funds and public offer funds where there's much greater numbers of people and distance between the employer and the member and the administrator and/or trustee. So that the costs of keeping tabs of employment status and age and all that I can see can be quite significant. But can you give me any comment from your constituency's perspective of the cost angle on this?

MR LORIMER: Certainly. From a self-managed fund perspective, on the basis that all the members are the trustees and vice-versa, obviously it goes without saying that they must know at any given point in time what their employment status is, that's fine. Where we see our proposal simplifying things, or reducing costs or complexity, is on the criteria governing whether or not a super fund can accept a contribution. Up to age 65 you have this issue of, "Well, you have to have been in at least part-time gainful employment in the two years prior to the acceptance of the contribution," and then after age 65 another set rules kicks in and then after age 70 it's not permitted and all those sorts of things. We just think there's too many layers of complexity or too many different scenarios for a person to deal with, to decide whether or not they can just simply make a contribution to a super fund.

MR FRENEY: I suppose for a SAF that is being run by an approved trustee entity, between the members of the fund and the approved trustee there has got to be information going backwards and forwards.

MR LORIMER: Yes.

MR FRENEY: About the numbers of hours per month, the contributing member - - -

MR LORIMER: Sure.

MR FRENEY: But it creates costs in that sense.

MR LORIMER: Yes, it does and, look, from a practitioner's perspective one of the most commonly asked questions I receive as a practitioner is from people who say, "Can I make a contribution to a super fund?" I mean, why should that be such a complicated question. They have to pay me for advice to see whether or not they can make a contribution. I mean, that's ludicrous, in my view. Certainly for that category of people who are under age 65, if we have this eligible spouse environment

where that sort of question doesn't have to be asked, why shouldn't it be the same in all situations? If somebody is of any age under age 65, irrespective of their employment status, the answer to the question should be, "Well, if you want to make a contribution to super you can, full stop, and then once you've made the contribution you must understand that if you're only 40 that you can't access those benefits until you're 65 or become employed and then retire," et cetera, et cetera. So that's where the costs specifically from our sector of the market are, from people just understanding whether or not they're eligible.

MR COSGROVE: On the more meaty issue of option 2, that's some very interesting material you've put before us in the submission and I was particularly interested in the apparent historical origins of some of these arrangements. There's no doubt that the number of fewer than five has an arbitrariness about it and from that point of view one could see some possible ways in which the problem which you're saying may not be very big anyway might be overcome, by changing that number. But the more critical factor here, I tend to think, is the relationship among the fund members. At the moment I think it's the case that they have to be related, whereas - in order to, you know, qualify for ATO coverage.

Your submission to us refers to matters such as relationship between fund members and/or trustees and perhaps, more significantly, that many of these funds could be limited to family members/business associates. Now, I wonder whether that's not opening - maybe not a terribly big Pandora's Box but a bit of an issue in terms of the nature of future relationships between people who are not related by blood, as they say. There can, I'm sure, be seen many examples of seemingly well-established business relationships which in the passage of time tend to be not as close as might have been envisaged and sometimes, you know, downright antipathetic. So, as I say, the issue in my mind at this stage seems to turn largely on the number of related members rather than the number of related members and/or some others who are, you know, in some way linked to these family members but are nevertheless not part of that family. Do you see any problems there, any that you could foreshadow?

MR LORIMER: The point is a very good one that you've made. What we would like to see here is this particular issue just debated more openly than it has been in the past. Now, we originally developed this argument in our involvement with the SLAB 3 of changes which introduced this new self-managed superannuation fund definition et cetera, et cetera, because quite clearly you had an arrangement prior to SLAB or SLAA 3, whatever you want to call it, for any fund with less than five members to be excluded from all of these disclosure and prudential obligations even though there might be one principal business operator with three arm's length employees in it. But it's clearly undesirable and it was obviously open to some potential abuse.

But in the debate leading up to the enactment of SLAA 3 we actually put this position on the fewer than five members issue to task, pretty much along the same

lines as what was expressed to you in our submission here, on the basis that we thought that the real question here is which funds require prudential supervision and which ones don't. That was what the Wallis report was all about and we concluded that the key characteristic or the key determining factor was the composition of the memberships of the funds and not the number of members, and by composition we're referring to the relationships between every single one of the members, between themselves and/or the trustee.

I think whether or not it's appropriate to draw into that relationship question some form of business associations or limit it to family members and then, if you're talking about just family members, to what extent do you define, you know, relatives and where do you draw the line? There's obviously some lines to be drawn in those sorts of things to ensure that there's no risk for any leakage. But what we'd really like to see in that respect is just really, taking a step back from where this current situation has got itself to at the moment, to examining once again which funds really require the element of prudential supervision that APRA's responsibility is all about.

Certainly once again, if I can put on my practitioner's hat for a moment, the vast majority of our APRA regulated funds have five or six members where every single member is of the one family group. Typically they're also involved in the family business. As a matter of APRA's routine audit or review work, they come in and review the compliance and other aspects of those particular superannuation funds but do so on the same basis, or no different a basis, to what they would for a fund that had 5000 arm's length employees where there's all sorts of other responsibilities and duties. Quite clearly to us - and I've spoken informally to APRA about it as well, in this regard. The current regime will not permit APRA to look at those funds in any other light than as if they do have 5000 members. They must have a look at it under this criteria.

Talking to APRA about this particular class of funds on a future sort of a basis, they understand and accept that there may well be a very strong argument for those funds to be more appropriately regulated by the Tax Office on the basis that they are probably really just self-managed funds with six members or seven members, or whatever it is. So they've expressed that view to me themselves because it has been quite apparent to them, as a result of their reviews of those funds, that it's a waste of their resources.

MR COSGROVE: No external vote is - - -

MR LORIMER: Precisely, and their memberships typically aren't open. They're set up, they're established on the same basis as a self-managed superannuation fund. They're limited to members of that family business or family unit and that's it. Their investment strategies and philosophies and all those sorts of things are typically the same as a self-managed fund. But the decision has been taken in those situations to just establish one superannuation fund with six members instead of two three-member funds, sort of thing, and achieve the same result.

MR McDOUGALL: Can I just add to that, it brings in the word discrimination. No matter where we look, we can't find a reason why the figure was adopted at less than five. You know, what was the reason behind adopting that figure? So you will get a family unit who will say, "We've got give members or six members or seven members in our family. But because of this arbitrary figure, yet we meet all the other criteria of no arm's length members and relationship, we're discriminated against," and that discrimination brings cost. When one looks at a fact that an ATO return is $45 and an APRA return is now $400 they ask a very strong question: why? And I think that is a very fair question that should be asked.

But I come back to the point that I raised earlier. What are we chasing? We don't know and I think before we actually try and put forward a solution, whether it be to you or whether it be to the issues paper that is currently out, we've got to know - I think we all need to know - what are the actual facts? That can be fairly easily resolved if there were some questions asked of the funds, that were pretty simple, that would come up - and I think ASFA referred to that same sort of thing: let's know what the position is before us.

MR COSGROVE: Could I seek some information on the other side of the coin. Are there any members of your Association operating APRA regulated small funds with fewer than five members? In other words, they're choosing to use the services of an approved trustee rather than operate the fund.

MR LORIMER: Yes.

MR COSGROVE: Is that a significant number or not?

MR McDOUGALL: You would find that the majority of SAFs have got an approved trustee and there's about five approved trustees who probably - and this is information given to us - those five approved trustees look after about 90 per cent of all SAFs. All bar one of them are members of our association.

MR COSGROVE: Right. But what I was really asking is, are those SAFs - or how many of those SAFs actually have fewer than five and therefore could be, if they wished, subject to ATO regulation rather than APRA regulation?

MR McDOUGALL: Yes, I can see your point. But we don't know. I haven't seen data on that. Whether the data has actually been collected on that, I don't know, and that's certainly something we could ask APRA. If that's on that return do they ask a number? That would be one question.

MR LORIMER: It's a question we could ask the actual approved trustees.

MR McDOUGALL: Yes, and they should know.

MR LORIMER: Certainly in my discussions with one of our approved trustee members is that I think they currently are trustee for around about 200 small APRA funds and typically those funds - in fact without exception I think and this is just simply based on my discussions with this particular trustee. Without exception they are one and two-member funds that, in the absence of having an approved trustee, would be self-managed funds, without exception. So there's no arm's length employee type arrangements in those entities. It's simply a situation where that particular option has been chosen because somebody might be - by way of example, somebody might be in retirement income mode and is worried from a succession perspective about what happens if I'm no longer of sound mind in terms of being the trustee and those sorts of things. So that's why the decision has been taken.

MR FRENEY: Can I just get lodged clearly in my mind - I think I've got it, but the implication of your comments in this area for our hearing is that there's a risk that some funds are being required to be SAFs because of this arbitrary definition of what is an SMSF and yet they may not need the kind of prudential supervision and the compliance costs that come out of having SIS fully applied to them. Like, if our job is to have a look at the SIS legislation and the cost effectiveness of the SIS legislation, you might say it's successively costly because it's being imposed upon certain funds that really could be in the ATO category and don't need to be in the SAF category if you follow your line of argument. Is that the point?

MR LORIMER: Not exactly.

MR FRENEY: I'm just wondering how we - - -

MR LORIMER: The class of fund we're not talking about here are not small APRA funds. They are just APRA-regulated funds. That's the first distinction, because we're talking about funds that have five or more members.

MR FRENEY: Yes, sorry. I used the wrong meaning.

MR LORIMER: That's all right but it's an important distinction because what we're saying is that we believe there are a number of APRA-regulated funds with very small membership bases where all of the members are related that could quite conceivably be redefined as self-managed funds. That would have to be with some sort of legislative amendment certainly but from an overall cost perspective they're being required to comply with all sorts of disclosure obligations and other issues which are totally inappropriate for that kind of fund and on the other side of the coin are imposing costs from APRA's perspective because they're tying up valuable resources in areas that just aren't - from a public policy perspective aren't necessary. The risk isn't there.

MR FRENEY: I'm just trying to tie your comments into our terms of reference to see how they relate.

MR LORIMER: Yes, sure. In respect of the small APRA funds, I think that's another argument. You have approved trustees that quite clearly and perhaps appropriately are subject to the licensing standards et cetera set down by - and net tangible asset requirements, all those sorts of things, to be so-called approved trustees, but the issue there is whether, because a small APRA fund with approved trustees simply comprises only one member or two members who are related to each other, whether they should be ATO-regulated or APRA-regulated, that is perhaps a separate argument on the basis - and once again, I've had informal discussions with APRA on this issue. There's a little bit of confusion, certainly from our perspective, whether there should be just regulating those approved trustees or all the funds underneath them as well.

At this point in time I don't really have a firm view on it. It's probably more appropriate that they look at the trustees, I think, than all of the individual underlying funds, on the basis that all of those funds are going to be subject to the same sort of compliance systems and operating - all those sorts of issues, but it is a difficult question to answer and it would certainly be undesirable to have - or perhaps inefficient or confusing to have the trustee subject to APRA's scrutiny or supervision but the fund itself lodging returns just with the Tax Office. That's obviously not going to wash real well.

MR FRENEY: I suppose all you're asking is that this topic be sort of reconsidered, to use your word, and I can understand that.

MR LORIMER: Absolutely.

MR FRENEY: I'm supposed to put my cards on the table about it. I understand very much what you're saying but I can't help wondering about how difficult it is not to define in legislation what you're trying to achieve. Just to perhaps be a little bit colourful about it, you could conceive of a very extended family situation or even a cooperative sort of situation where you might have a hundred people in the cooperative who have all got exactly the same relationships with each other and with a board of trustees et cetera et cetera and yet you might not really think that it would be appropriate to have a fund like that being within the SMSF category. So the actual way in which you write this up in legislation might be one of the problems and thus a reason why you have to go back to what might be a rather arbitrary number picking exercise and it could be part of the historical reasons.

MR McDOUGALL: I think you've raised a very important point and we're not saying that - we're not sure whether you say that you should have a figure and it should be, where it's currently less than five maybe it should be less than eight and maybe it should be less than nine or less than 10; or whether we're saying it should be abolished. The reason we're not saying that is because we can't get any factual information to tell us what are the funds, what do the funds have. If the fund returns of this sector were required to put in it the number of people in the fund as well as whether they had arm's length employees or not, or arm's length members or not, you

could then have some statistical data that you could be able to base the answer on that you're asking the question of, that it might come up and say, "Look, 99 per cent of these funds that have no arm's length members actually come within less than eight and on that basis that might be a reasonable outcome."

The point is, we're fishing because we don't know and I think it's a fair question and the point is that we should know.

MR COSGROVE: I realise that from your point of view the preferred approach is along the lines we've just been discussing and that you know, you think accordingly that a licensing arrangement is really not called for but with a view to helping us understand what some of the implications of a licensing proposal might be from your perspective, I wonder if you could advance - I don't know whether you have our draft report with you but so far as small or corporate funds are concerned, for the most part at least, what our proposal involved was a licensing of that fund, subject to certain conditions imposed on the trustees. Down at the bottom of page 119 you can see those conditions. Are there any of those conditions that you would regard as unnecessarily onerous or undesirable? The minimum operating capital one could be a problem for your members, I would imagine but I'm not sure about the others.

MR LORIMER: Yes, certainly, the operating capital clearly. That goes without saying.

MR COSGROVE: They just don't need it.

MR LORIMER: It's irrelevant. It would serve absolutely no purpose whatsoever and would just simply require either a portion of the fund to be pulled out and left aside without being able to be invested for the benefit of the members or that capital to be drawn from elsewhere for absolutely no purpose whatsoever.

MR FRENEY: Is that, Michael, because your constituency is using approved trustees - sorry, I'm not talking about SMSFs. I'm talking about SAFs. They're using approved trustee facilities to be running their funds and so there's cash flows that are going annually. Sorry, there's an annual payment to the approved trustee and that comes out of the resources of the fund.

MR LORIMER: Sure. That requirement is already in, yes.

MR FRENEY: So that it's sort of covered in the sense of - - -

MR LORIMER: Absolutely. Yes, the small APRA funds are already covered, absolutely. Yes, that's fine. The requirements relating to capacity to manage, I think we would - I can't specifically recall ASFA's remarks on this particular issue but I remember when I had the benefit of hearing their comments earlier that I thought I would endorse their position. It would be extremely difficult to actually set any benchmarks for whether or not a person or persons or entity has the capacity to be a

trustee. I mean, what would the benchmarks or criteria be and really, whose place is it to say whether or not you should or shouldn't be a trustee? Counter that or support that with the argument that - the fact that highly qualified and professional directors of some corporate trustees and approved trustees have still caused those funds to collapse and perhaps that's where the higher risks are than for people who are just lay trustees, if I can call them that. Provision of - - -

MR FRENEY: Sorry, I may have been a bit off-beam a minute ago, too. Just thinking through this a bit more, what we're talking about here, just take the SAFs category and what we're talking about is that the trustee entity ought to have - or we're posing the question, it should have these kind of characteristics. So what we're saying is if you've got an approved trustee that's managing a whole lot of SAFs, wouldn't you as the member of a SAF that was using that approved trustee want to have some confidence that the approved trustee had a certain capacity to manage the fund and had a certain amount of wherewithal, operating capital, if you will, to run the fund? That's what this is saying for SAFs. Maybe some of your other constituents are self-contained small funds and I think they would almost make the same point. Shouldn't there be some capacity and capability of whoever it is running the fund to actually be able to do it? That's what I was asking ASFA this morning.

MR McDOUGALL: I would agree with that principle but I've got to ask the question and I know that it's hard to answer this on the basis that we're pre-empting a lack of knowledge of what's going to come out for some findings of some current investigations in relation to the case on commercial nominees and one of the things that is going to be interesting to come out of that is what was the break-up of the funds that were actually in the investment? How many of them were SAFs? How many of them were self-managed funds? How many of them were small corporate funds who were investing in that activity and what was the percentage of the losses related to the different classes of funds? One would assume that if you're a licensed trustee and approved trustee then you've had to meet some certain requirements under the current regime that would give the principal - or I think should give to the member of a SAF that there is some surety that the person acting on their behalf has been fully checked.

The one question that comes to my mind is my understanding is that the surety that a professional trustee gives is under three categories and also my understanding is that the $5 million in this particular case was related to a custodian rather than the actual funds or a bank guarantee. I would therefore ask the question: if that is the case, why wouldn't that $5 million put up by the custodian under the regime put in place by the regulator be able to be got to as it would be in the other two cases. I think that if it turns out that that is not possible, then I think the member of a SAF has got a legitimate question to ask of the regulator, why were we put in that position? But I'm pre-empting that because we don't know what's out but that certainly is of concern.

MR COSGROVE: Right. Well, my comment - - -

MR McDOUGALL: Did you want us to comment about the other two - - -

MR COSGROVE: - - - is at the top of page 120, yes.

MR LORIMER: So the provision of an investment strategy - - -

MR COSGROVE: By the trustee.

MR LORIMER: That's intended to require that - - -

MR COSGROVE: The trustee of a fund.

MR LORIMER: - - - the trustee of the fund, when looking at whether or not they can be a trustee of the fund - - -

MR COSGROVE: Well, whether the fund can be licensed, yes.

MR LORIMER: Yes, I don't think that the provision of an investment strategy is of any real benefit or whether there is any need for that particular issue when the requirement to have an investment strategy is already embraced in the act and regulations. It's an operating standard and it's obviously subject to the approved audit process and all those sorts of things. The provision of it up front to APRA I don't think would serve any purpose. The major issue in respect of the investment strategy requirement is the emphasis on the trustee of any entity giving effect to what it says is its strategy. I think that is the major thing here. If you give somebody a bit of paper and say, "That's our strategy" and you give them a tick to say, "You can be a trustee of that particular fund" is just a tick and flip type of approach and will serve no real benefit.

MR COSGROVE: Except perhaps in the circumstance in which a potential trustee came along and said, "I'm going to have a portfolio of 100 per cent in asset X", then presumably the regulator would say, "No, you are not." But I take your point about the application of the strategy being very important.

MR LORIMER: Yes, giving effect to it is more important and I think that is where the approved audit process plays a very important role in this whole function. It is not going to stop poor investment performances because of markets generally, but if a trustee says that they are going to have a well diversified portfolio according to their strategy and come annual audit time they have 100 per cent of their assets tied up in ill-liquid investments and they are a large employee-type fund that could be reasonably expected to have quite high liquidity requirements, then obviously the alarm bells are sounded. If that mechanism isn't working at the moment, then I would suggest that is where any focus should be as opposed to the provision of just a document up front or something like that as a criterion.

MR COSGROVE: Independent orders - I guess nobody could have too much trouble with that?

MR McDOUGALL: Obviously we are interested in the outcome of the current discussions that are taking place, the round table and the position that both, obviously the two accountancy bodies, would be putting forward in regard to that. One of the things that we would be conscious of is that whatever is the outcome of it is that we are not adding substantially to costs of running a fund. So we are not adding anything unnecessarily to running a fund and we are certainly aware of the concerns that have been raised and acknowledge them and will participate in any discussions.

MR COSGROVE: I have two other questions which you might be able to help us on. They concern some request for information which we have made in the course of the draft report. Do your members have any concerns about the costs of complying with what are called small accounts and lost member accounts?

MR LORIMER: No, none to report on.

MR COSGROVE: The other one related to the much discussed issue of the deadline for the lodging of annual returns with APRA. You probably have a lot of SAFS in the - - -

MR McDOUGALL: SAFs particularly. In actual fact that is something that is something that I have already had some preliminary discussions with APRA on and we certainly are going to have some further discussions and I have been specifically discussing this with the SAF members of the association, because it really does apply to them. Certainly I can only say that APRA are certainly interested in sitting down and having a discussion and we will be going forward with those discussions. But there is obviously some irregularity in relation to some of the investment trusts reporting return requirement dates which then clash with the return date for a SAF.

MR COSGROVE: Do you mean that they are out of synchronisation?

MR McDOUGALL: They are out of sync, yes.

MR COSGROVE: So they might report in March and September, but not in July?

MR McDOUGALL: That's right.

MR LORIMER: To put a practical lien on it, to enable any APRA regulated super fund, SAF or otherwise, to meet it's 31 October lodgment deadline, requires it to have all of the information, financial information and investment information together to enable a set of financial accounts to be prepared and audited within four months of balance date. I mentioned a practical lien, we have a situation in respect of the 2000 year in particular, but in respect of the 2001 year where some of this investment situation that Graeme is referring to, where the balance date is the same,

still 30 June, but a super fund that has an investment in a managed fund of some description is not getting its final tax statements et cetera to be able to prepare its final accounts and returns until the end of September or early October. Then it has two weeks with which to finalise everything, get it audited from a compliance and financial respect and have the trustee sign returns and accounts and lodged - it's just a physical impossibility on the basis that there are two many external factors inhibiting that deadline.

MR COSGROVE: Are these instances very common?

MR LORIMER: From a practical perspective, yes. The 2000 year was probably - I notice in the report that APRA had provided some interesting statistics on the lack of returns being lodged at different points in time. I think the 2000 year was a poor sample to use, because it was notorious for all sorts of changes being introduced. So there were a number of external factors there stopping any superannuation fund in Australia meeting that new deadline. Firstly, the 31 October deadline was only first applicable for the 2000 year, so there was that adjustment to make for funds, but in addition you had the requirements for some of those funds to implement BAS or IAS reporting and with the changes to capital gains tax that occurred during the year, the number of fund managers that were issuing the year in tax statements were having three goes at trying to produce final tax statements because of all those changes. It was an absolute disaster of a year for any fund to try and comply with that new reporting obligation.

It would be more interesting I think to have a look at the performance of funds this year, but certainly once again from a practical perspective, there are two many external factors that get in the way of funds efficiently being able to comply with that deadline. No matter how well your systems are in place and no matter how efficient those systems are, in the absence of all that information, if you are relying on it from other third parties, you can't get the job done, with the best intentions. That is a fact of life.

MR McDOUGALL: As an example, it was only last week that I actually had a call from one of the professional trustees asking - because they had so many they were trying to finalise because of the late information - if we could advise them of whether we knew of any experienced auditors of small funds that they could farm some of the work out to with an attempt to try and meet those dates, but they didn't think they were going to be able to do so. Because if they had stuck with their normal audit process, they were fearful that they were going to get penalised and they were looking around trying to find ways to be able to overcome the problem. So it's a real problem out there.

MR LORIMER: Specifically for the small APRA funds, I mean there is probably an argument to suggest that the funds themselves could have an extended lodgment period, provided that the trustee still lodges its return and accounts and those sorts of things within that sort of deadline. As I understand it, under the standard instruments

for approval that APRA issues for those sorts of things, the instrument of approval itself requires the trustee, the approved trustee, to lodge its own audited financial statements et cetera and other information and certifications within that four-month period. So provided its complying with that, perhaps it is of less significance for those funds themselves to have that four-month deadline as well.

MR COSGROVE: Although I guess from APRA's perspective they want to know about the performance of funds in case there are risky - - -

MR LORIMER: Certainly, absolutely.

MR COSGROVE: - - - factors at work, yes.

MR LORIMER: It's not a question of people not wanting to do the job, it's a question of people being able to do the job within the required time.

MR FRENEY: Could I ask is the late recording of investment returns and tax positions and the like this year coming from relatively commonly used listed unit trust investment managers in Australia?

MR LORIMER: Yes.

MR FRENEY: It's not on account of some exotic or offshore investments - - -

MR LORIMER: No.

MR FRENEY: - - - that are happening to use - - -

MR LORIMER: They have been big name fund managers and it has just been once again a case of - they are obviously subject to getting information together and getting their information audited to some extent, whatever their obligations are and reporting to their clients. But sometimes it doesn't give the ultimate end user adequate time to meet its own obligations, with the best of intentions.

MR FRENEY: Maybe if I could just very quickly, because we are running out of time, but I remembered from your initial report to us, your submission to us, that at the end of it you commented on a bit of overlap between the regulators in terms of APRA and ASIC regulatory responsibilities and you gave some examples about the APRA inspections commenting on the supply of information to the members of superannuation funds giving some commentary about the adequacy of that and the referring it to ASIC and ASIC in turn - which didn't appear to be prima facie a 100 per cent perfect kind of regulatory interface. I was just wondering if you had any updated comments on that? Has anything changed much since you gave us those comments?

MR LORIMER: No, I can honestly say nothing has changed much. I mean there

is obviously a memorandum of understanding of sorts between APRA and ASIC on those sorts of things, but there has been no change to that perspective. Certainly as far as any of APRA's routine reviews of individual superannuation funds are continuing to progress at the moment, this situation is still arising, in that APRA's review will from its own terms of reference cover in very general terms things like disclosure to members and those sorts of issues. The comments are still being made in very general terms without really committing to express any opinion and that if they have any concern that it is a little bit inadequate, the comment is being made and there are reports that they may consider referring that particular issue over to ASIC if they think so. What happens from there we don't know. I mean we certainly haven't had to follow up any ASIC review questions in response of any cases that have been referred on that basis. But it does seem to us to be an inefficient or a little confusing sort of process.

Certainly from a trustee's perspective you would expect that if APRA was performing this review it would cover all of those sorts of things and they would give you their opinions and findings and if any changes or recommendations were made, then you would expect that to come out in that report, as opposed to saying, "We will refer it over to these people and they may or may not decide to do anything." It is difficult to know where you stand from a practical perspective. It is possibly not a major concern going forward. The most important thing there is just to ensure that if there are any major deficiencies being identified by APRA as part of their review, specifically outside of their supervisory obligations, that the referral mechanism across to ASIC for it to be adequately dealt with is in fact there and that it does happen. That is probably the major risk we would see.

MR COSGROVE: I think that is all we have to raise with you, unless there is anything else you wanted to draw to our attention. Thank you again for a very interesting input to the inquiry.

MR LORIMER: Our pleasure.

MR COSGROVE: I think we will just take a short break now.

MR COSGROVE: Our next participant is Mr Peter Timmins. Mr Timmins, just for having our voice on our transcript would you mind please stating your name and the capacity in which you're with us today.

MR TIMMINS: Yes, my name is Peter Timmins. I'm appearing as an individual. Do you need any other details?

MR COSGROVE: No, that's adequate. We've received from you recently some dot points about the matters you've planned to raise. I guess you'd like to elaborate on those today.

MR TIMMINS: Thanks for that. I only became aware of your draft report fairly recently, in fact through seeing the ad that you were having these hearings today. That led me to have a quick look at the report and to give you that very brief email. I guess the issues I'd like to raise with you are about section 120 of the Act and the disqualified persons provisions. I note that in the draft report you don't make any recommendations for change. I think I mistakenly read in my first brief look at the report that draft recommendation 6.4 was relevant but it's not, as I've had a closer look at it.

MR COSGROVE: I was wondering about that.

MR TIMMINS: But it is about the disqualified persons provisions. It would be my view that these are excessive, unjust and unfair and do have some undesirable outcomes, and I think it's therefore relevant to your term of reference. I don't see it as the major or indeed probably one of the top issues you need to concern yourself about, but I think it is an important one.

MR COSGROVE: It's a part of it, certainly, yes.

MR TIMMINS: I acknowledge that the provisions of the Act now include another section, 120(6)(b), where there are provisions in the act for applications for waiver of the disqualified person provisions where there are offences not involving serious dishonest conduct. Section 120(6)(d) lists some of the factors that should be taken into account in reaching a conclusion about that. The issues I'd like to raise with you come from personal experience. I first became aware of these section 120 provisions not long after the Act was introduced when I was the director of a public offer fund. In order to be licensed I completed returns that the management of the organisation - it was quite a large fund, several billion dollars, and I completed forms that management presented and lodged them and within six weeks or two months I was shocked to receive a letter from the ISC which asked me to show cause why I should not be regarded as a disqualified person.

The letter reminded me that in 1955, which was 40 years before the letter was received, I had been charged with breaking and entering with intent and in a Children's Court the matter was dealt with under the Child Welfare Act and, while

there was no finding of guilt and there was no conviction recorded, as a result of that appearance I was placed on probation for nine months and a good behaviour bond. I'd have to say that was a sort of rather significant changing point in my life, looking back on it. That year a long time ago, I repeated that year at school and two years later did rather well in the final year at school and went on to university. While no integrity tests are required, I ended up graduating with an arts degree and honours degree in law. 10 years after the event, in 1965, I applied for admission as a solicitor of the Supreme Court of New South Wales. I don't recall whether there was a spent conviction provision around it that time, but I declared the event of 1955 and this was not seen to be a bar to being admitted as a solicitor to the Supreme Court of New South Wales.

In the same year I was accepted as a foreign service officer by the then department of external affairs and joined the Australian foreign service. Again I don't recall anything about spent convictions, but I declared by 1955 incident and received a security clearance, which I retained for the next 15 years as I occupied senior positions with the department in Canberra and overseas, in Korea, Vietnam and the United States. I left government some time after this and occupied a chief executive officer position in the financial services industry, and I might tell you that the events of 1955 were very much forgotten by me when I signed those forms and when I received that letter in 1995.

I made an application, or an application was made on my behalf, for what were then temporary modification provisions that existed in the act that enabled the Commissioner during the first year of the operation of the Act to make some orders, and these have now been replaced by what's in there now for dealing with these matters but they weren't there at the time. I'd have to tell you that this was a maturing experience for me. I obviously had to disclose this to the other colleagues on the board and to senior management and they were all very supportive, I might tell you. There was quite a lot of jocular exchange about, "In fact, I was once apprehended for not paying my fare on a train. Do you think that's dishonest conduct?" I heard from someone else that sort of almost innocently they'd been involved in a joy ride once in a stolen car and the police pulled them over for that; was that dishonest conduct? So people were very supportive of me and I did subsequently receive a notice following these representations and a provision of all of the information that the Act now requires that I, if you like, was not to be regarded as a disqualified person.

But I have to tell you that I've been patronised a few times in my life but that letter really was something that stuck in my craw because in terms of the Act the then Commissioner, Mr Pooley, had to reach a judgment that I was unlikely to pose a danger to the funds under management. I must say I had thought by 1995 and in light of other things and experiences it was rather interesting for a public servant to exercise his discretion in that way and use what I regarded as rather quaint words about his finding about my suitability to continue as a trustee.

I wondered at the time how many other people were out there like me and I made a freedom of information application to the ISC for all the documents they held about me, because I was also intrigued how this came to light. It is an offence for an officer of the New South Wales police service to provide information to anyone else about a spent conviction, this having been spent under the laws of New South Wales many, many years before - under the laws of New South Wales it was spent by 1960 - but I was interested in just seeing what documents the ISC had about me and I was also interested to see who else was having a problem about this. For freedom of information application excluded any request for identifying details but did seek any documents held by the ISC about people who were in the same situation as me.

Mr Freney, you might recall that because you were the decision-maker on my freedom of information application. I've kept a file of these with I guess large amounts that are blacked out, but what it did disclose was that I was not alone. I guess one of the most striking incidents of me not being alone was a copy of a letter that I obtained as a result of this freedom of information application dated 11 July. It's addressed to the then treasurer and it's making representations but, as this person recalled, in 1968, so that is 27 years before this time. "I was convicted of receiving stolen property," says this person. He says that he was innocent and of course I have no idea whether he was or wasn't, but then this letter sets out why a lawyer that he had at the time told him that he should plead guilty because in all the circumstances that was going to get the best result. As this person pointed out in the letter, "Looking back on this I very much regret it and this isn't the opportunity for me to reopen the matter," but it's an example of what he regarded as unjust treatment by this provision.

Another letter that came into my possession at this time was from someone who was charged as a result of leaving a hotel with a beer glass. This was an offence involving dishonest conduct and a finding had been made. I don't know what happened to these people. I can tell you appearing here today took a bit of a decision, because I imagine a lot of us have been a bit cowed by these provisions because speaking up again I guess brings to attention something in the past that you're not very proud of. But I have no idea what happened to these people. I have no idea how many people are out there in this situation but, as you might guess, it struck in my craw a bit.

What we are trying to achieve are very important public purposes about the management of superannuation funds, making sure that people who don't have I guess wrong motives or intentions or interests aren't involved. It seems to me what we're trying to do in the legislation here is excessive. It goes far beyond the Corporations Law, it goes far beyond the requirements we have for people to be admitted to professions. The people who sit in judgment on these matters are public servants who themselves are not required to comply with such an onerous provision in terms of their appointment to the public service or continued employment in the public service, and we're lumping in all sorts of possible things. As I say, it seems to me that offences committed by someone who is still within the jurisdiction of the

Children's Court are rather different than the sorts of things we should be concerned about in legislation of this kind.

I've never had any other offence. I've satisfied whenever there's been a fit and proper person test those tests, and I think I've been through a few of them, but I would fail the guilty of dishonest conduct test in the SIS legislation unless there were these modifying provisions. In order to get the exercise of those modifying provisions, I have got to go through a process that I regard as potentially humiliating, and I don't think it's just. I've no idea what's happened since. I haven't made another freedom of information application to the ISC, so my information about the effect of this is rather dated. I don't know to what extent it has been a significant problem. I have no idea, and I presume the ISC doesn't either, of how many people would have been put off by it in terms of putting themselves forward as a trustee. My guess is many of them wouldn't be aware of it until you find yourself in that situation. You either are mindful that the spent conviction provisions do not apply and, even if you appeared in a court process and there was a finding and the judgment was that it's not to see a conviction recorded, that this provision of the Act overrides that as well.

I've always thought that what happened to me was that a conviction was not recorded. What does that mean? It means that there are records about it and the words might appear "Conviction not recorded", but I can tell you something is recorded and it's still around the police system coming on 50 years later. So I think it's excessive. I'm not sure it can be justified. I do agree with the important public purpose we're trying to manage here. Does this produce competent trustees? Does it save us from people who we need to be saved from? I'm sure that some people get knocked out by this who shouldn't go near a superannuation fund, but I can tell you that in my case - I'm not sure how many others; I think some other people run into some difficulty with this provision. If you have a look at the Corporations Law, I think section 208B - - -

MR COSGROVE: 208B?

MR TIMMINS: I think that's right. I just made a note to myself today about it. In 208B you have provisions that disbar people from being company directors. The spent convictions provisions apply, so therefore if you have things in your past and there's been an important public policy judgment but enough time has lapsed for that to now be put aside, that applies to people who are covered by the Corps Law. The Corps Law says in 208B that you can't be a director if you've been found guilty of dishonesty where the offence is punishable by imprisonment for at least three months. I'd have to suggest there's probably a difference between dishonesty and dishonest conduct. I was found guilty of breaking and entering with intent. I went with some other kids my age and we hopped into a school on a Sunday morning through an open window. Nothing was taken.

I imagine in nine times out of 10 in those times the policeman would have given us a kick in the tail and that would have had the salutary effect that he

intended. I had the misfortune of being involved in that. Nothing was taken. There was no evidence provided in the case about that but it's stuck with me now for a long, long time. I would suggest that that wasn't an offence involving dishonesty, but the ISC at the time thought that what I did, breaking and entering with intent, was an offence involving dishonest conduct.

I would suggest we probably should have some similar terms used here. If there's a good reason for using dishonest conduct in the SIS legislation let's explain it. It would be probably even better if we defined it, which we don't do. Again, I'm not familiar with whether the ISC, now APRA, obtained legal advice and whether all this is now a well-developed body of law. I've not ever heard of a case arising as a result of the SIS legislation. I don't know, I haven't researched it to that extent but I think that there's a need for some compatability between these regimes and if there's not there should be a good reason why. I'm not quite sure whether we got that right in the legislation at the moment.

What could we do? I guess my suggestions would be we should have a look at whether the spent convictions provisions, which have been enacted in Commonwealth and state laws for good public policy reasons - whether there's any special reason why they shouldn't apply. I understand that the bill originally when it went into parliament is not the way it came out and the original proposal of this bill was that the spent convictions provision would apply. Somewhere in the legislative process it was changed. I've heard it said that it was a Robert Maxwell amendment.

MR COSGROVE: In the UK?

MR TIMMINS: Yes, that if Robert Maxwell was re-examined - his history was re-examined, it would be found that he had a childhood or an offence earlier about dishonest conduct and he wouldn't have got his hands on the printers' superannuation money. I don't know, I have not researched it, but I think that's one thing that should be looked at. Secondly, shouldn't we exclude children's offences? Is there a good public policy reason why things that come within the jurisdiction of the Children's Court should remain with people beyond the spent convictions period? Thirdly, I think it would be worth looking at whether you define dishonest conduct. Fourthly, I think there's some scope for some similar use of terms in the Corporations Act and in the SIS legislation. Five, I think APRA should retain a fit and proper person discretion which they do have at the moment, defined for no doubt good reason, that someone isn't fit and proper and shouldn't be involved.

I guess a bit of a wild card is that I suppose in legislation of this kind you could impose a disclosure requirement that anyone who was appointed to the position of a trustee and came within the provisions of the Act was required to bring to the attention of the entity at least any matter relevant to fitness to carry out the duties of a trustee. I haven't explored those in any detail but they're just thoughts of mine and I was prompted to put them down because when I did come at a fairly late stage to read your draft report I thought it was an important issue that isn't addressed. So

thank you for the opportunity to make a few comments.

MR COSGROVE: Thank you, Mr Timmins. It's an interesting illustration of how perspectives on a particular piece of regulation may be misjudged. If anything, as you will have seen in our draft report, we were sort of indicating that this test in itself was a bit of a feather duster, yet you've been able to show us that in a seemingly innocuous case it's had more effect than that.

MR TIMMINS: I think it would be wrong - I mean, I do a bit of work around this area - to make decisions about public policy based on one experience or an anecdote but I guess what has never come to light is, is this an issue? As I say, I was prompted by that thinking to make this FOI application which I got a bit but this was a long time ago and there must be six years' more experience. I have no idea what ISC and APRA have about this. They may have very cogent arguments about why we should retain what we've got but if you haven't heard them I would suggest you probably should because I think there are some unforeseen - maybe they weren't unforeseen. Maybe this is what parliament intended. I notice in a lot of the letters that were written at the time that officers of the ISC were talking about what parliament has intended to override; the spent convictions provisions. There's very good reasons why it's done this. If there's good reasons about offences dealt with by the Children's Court to be in there I would like to hear them.

MR COSGROVE: Yes, I think you've put some interesting points to us that we would not otherwise have been aware of and thank you for doing it.

MR TIMMINS: As I say, I think I'm probably not surprised that you haven't had too many submissions. I mean, I wondered myself if I had counsel that I shouldn't. I mean, I must say that I'm currently on the board of a company that operates in the financial services business. It in fact owns a company that is a trustee and has public offer funds. I'm not on the board of that but I'm on the group board and I must say I told the chairman and he recalled my experiences of some years ago and he said, "Do you really want to do this? Why don't I make it and we'll sort of keep it quiet who you are." I said, "No, Reg, that's exactly my point, that I shouldn't be in a position where this isn't brought to public attention." But I bet there's a lot of people - and I don't have their names and I'm not interested in their names but I just wonder, is there some injustice being done here on not an enormous scale but an injustice to a number of people that's quite significant.

MR COSGROVE: Yes, it would be interesting for us to have a look at the Corporations Law provision that you referred us to and as you say, one would need to have good reasons for thinking why there shouldn't be some degree of compatability, if not fairness - - -

MR TIMMINS: As I say, there is something in there about dishonesty but it's different from dishonest conduct and at the time I made my application for waiver I did utilise a firm of solicitors and they said there's a bit of an argument that it's not

dishonest conduct but that wasn't the view that was held in the ISC and I think it is capable of quite broad interpretation. It certainly does include people who got picked up on a charge of stealing a car when they were on a joy-ride for 10 minutes. Whether it picks up someone who didn't pay their fare on the train is another matter but I think these are a different scale than the legislative intent, which must have been to try and ensure that superannuation funds are appropriately protected.

MR COSGROVE: There's one general point you might be able to help me on, Mr Timmins and that is in terms of these existing section 120 provisions, I looked at them myself, having been alerted to your interest in our inquiry and the section 120D which sets out the conditions under which APRA can waive disqualified status seemed to be as open as you would like. In fact, the last of those is literally any other relevant matter.

MR TIMMINS: Any other relevant matter.

MR COSGROVE: So my question is really, is this more a question of application of regulation rather than the problem in the regulation itself?

MR TIMMINS: It seems to me that it's just giving public servants a discretion and some of my best friends are public servants, I think. I spent a lot of time around the public sector but it just seems inappropriate that in some cases we haven't excluded certain things from the operation of the Act. So I guess what I'm objecting to is there's still a discretion there. Now, public servants exercise many discretions. They do them usually well. We do have a system of review of the exercise of discretion in many areas. I've never checked whether this is something that's subject to the Administrative Appeals Tribunal jurisdiction. I don't know.

MR COSGROVE: No, nor do I. It may be, I don't know.

MR TIMMINS: It may be. So as I say, I know about the exercise of discretion. In my case discretion was exercised. I have to tell you, it led to a letter that I still - I don't go back and read it but I still very much recall. It sort of said, "Well, after 40 years we think you're probably mature enough now not to represent a danger to a super fund." I thought, gee, okay, I'll take it but - - -

MR COSGROVE: I can understand. Thanks again for drawing this matter to our attention which otherwise we wouldn't have known about.

MR TIMMINS: Okay, thanks very much.

MR COSGROVE: Our next participant today is the Institute of Chartered Accountants. Richard, could you as you've done before in an earlier stage, identify yourself and the capacity in which you're here today.

MR RASSI: Sure. I'm Richard Rassi. I'm here as chairman of the National Superannuation Task Force of the Institute of Chartered Accountants in Australia.

MR COSGROVE: Thank you, and thank you for taking the trouble to put together some reactions to our draft report. We've had a quick read of them earlier today. Do you want to make any opening remarks about the matter?

MR RASSI: I suppose just as an overall comment, I guess from where we stand we'd like to make sure that with all the reviews that are currently taking place that there's some coordination. Right now at the very moment there is obviously this hearing. There has been a senate select hearing very recently. There is also a paper out by the minister on strengthening the framework of super and I think it's very important for the industry to ensure that there's a coordinated review. We as a professional body strongly recommend and support the notion of an overall review of the industry. There's lots of scope for improvement, refinement, streamlining but it needs to be a coordinated one and I guess that's as an overall comment.

MR COSGROVE: It's a fair point.

MR RASSI: Apart from that, you know, I've got obviously a number of comments on some of the recommendations and comments in regards to some of your requests for information which I'm happy to review with you.

MR COSGROVE: You've been very diligent and we're grateful for that. I think my first question - I'll let Roger jump in if he has anything earlier - is the one about the compliance audits. You make quite a point there about the problems that could arise with the separation of a financial audit from a compliance audit. I'm not well-schooled in this area. Perhaps you could explain to me the nature of those problems.

MR RASSI: Yes, sure.

MR COSGROVE: I was also wondering, are there any problems of timing here that you can't separate in time the conduct of a compliance audit from that of a financial set of books? Anyway, in more general terms if you wish, what is the real problem here?

MR RASSI: I think there are significant synergies between a compliance audit and a financial statement audit and that has been very clearly documented by the profession and also documented in the way the audit programs are designed by the typical auditor performing the audit of a superannuation fund. The synergies are that for a number of the key operating areas - and I'll give you an example. For example,

the benefits payment cycle of a superannuation fund has financial elements as well as compliance elements and it's just very efficient for the auditor to actually cover off both the compliance aspects and the financial statement aspects of that particular transaction cycle. To disaggregate the two, yes, it is physically possible to do that but I think it would come as an added cost to the process.

So typically, when we go in to do an audit, even when we do design an audit over a series of stages for the larger funds where we go in and do an interim audit followed by a final audit, those audits are conducted with those two elements and always an integrated approach is taken to performing the overall audit approach.

MR COSGROVE: I wanted to properly understand the final part of your comment in that area where you say:

> Many trustees already use other service providers to help establish and monitor compliance, for example compliance officers. Much of this work is relied upon and retested by the external auditor.

So you're saying that these are internal procedures.

MR RASSI: Correct.

MR COSGROVE: Yes, I see.

MR RASSI: This is normally in the much larger end of the industry spectrum you will have - obviously with the larger players you will have internal audit facilities, compliance officers. I mean, we try not to duplicate all of the work. We would place as much reliance as we can on the work that they do, perform summary testing, perform some of our own work, but we don't ignore what they do internally to gain maximum efficiency out of that process. At the smaller end you don't have that. I mean, there's no work conducted by anyone at the smaller end and we've got to go and do all of the testing ourselves.

MR COSGROVE: We have heard a few examples - I couldn't put the number any more than that - of approved external auditors - actual auditors, for want of a better label - employing people with other skills to actually do the audit but the approved auditor signs off on it, a compliance audit, I'm talking about. Are you aware of that being much of a general practice or is it fairly uncommon?

MR RASSI: In the large accounting firms we do tend to have people from different disciplines and I know that in some of the large accounting firms they have employed people with a superannuation type background as opposed to an accounting background and those people are used to help with the audit process because of their expertise but, you know, it's not widespread and only some of the firms have gone down that track. Certainly in our firm we haven't gone down that track.

MR COSGROVE: Would such people, those knowledgeable about superannuation, be able to be of assistance or even to undertake - probably couldn't undertake a financial audit but from the point of view of the synergy you were referring to earlier, how do they fit in? Are they operating more or less independently?

MR RASSI: They fit in - they're not. The partner responsible for the overall engagement would actually use their resources or use their time and use their expertise, but that particular partner would be directing the overall audit and would take responsibility for the overall audit. So he's merely using a resource within the firm but directing that resource and taking the overall responsibility. So they're certainly not working independently and that audit partner would drive the timing, the nature and the extent of the audit procedures both in the financial statement and in the compliance area because it's his signature that goes on the report.

MR COSGROVE: Yes. From the point of view of trustees of funds, if such an arrangement was available, that is, they could use someone other than a financial auditor to do the compliance audit, would there be any problem in that? If this was more costly then I guess they wouldn't be inclined to use such an opportunity and of course there's no use of it at present, so we're talking about an unknown outcome of a change.

MR RASSI: Yes. I mean, as a concept, yes, certainly you could have lawyers perform that compliance work. But in my experience the audit profession and audit practitioners are probably better attuned to testing and auditing for compliance. So where I think the strength of other professionals is, such as the lawyers, is in actually looking at the legal documentation, the trust deed, the documents that a fund has to produce under law and advising on wording, contracts et cetera. I think the audit profession's strength is in actually testing the operation of a fund in accordance with the law. Some of those compliance requirements have to be tested on a sample basis.

You can't expect to go through every benefit payment to see that the preservation requirements have been met. You can't go through every single new member that has joined the fund and make sure that he is being given the information that he's meant to be given under SIS. It's physically not possible and I think that's where the audit profession comes into play, where practitioners are trained and accustomed to performing samples, statistical samples, and directing testing of various aspects of the operation of the plan and that includes the compliance aspects. I think some professional groups may struggle with that concept of sampling and testing and arriving at an overall conclusion on a population based on sample testing.

MR COSGROVE: Incidentally are the requirements of the Managed Investments Act in this area the same as those under the SIS Act?

MR RASSI: No, they're quite different. The requirements under the MIA Act are

much more onerous. The compliance requirements or the compliance audit performed by an auditor is much more extensive than under SIS.

MR COSGROVE: But I was thinking more the task being confined to - - -

MR RASSI: The task has got similarities, absolutely. There's obviously a lot of similarity in the process. But when one audits a compliance plan under an MIA regime one is more concerned about auditing processes and there is a lot more to actually cover off in a compliance plan audit as compared to a compliance audit of a SIS regulated product.

MR COSGROVE: And the compliance audit must be undertaken only by people who are accredited members of, you know, the Institute of Chartered Accountants or what have you.

MR RASSI: Correct, yes.

MR COSGROVE: Okay, that's all I wanted to know.

MR FRENEY: Yes. Could you envisage it being feasible that some other superannuation professionals such as lawyers or administrators could work with the auditor, the appointed auditor, on a compliance audit? The sort of submissions that were coming to us was that they're effectively excluded, and so it's a restraint on competition, from being able to contribute to the external compliance audit process. So in some geographic regions, in some areas of the market, you could envisage a situation where, because of shortages of skill supply, the process might actually be facilitated if you could see certain law firms or superannuation professionals contributing to the compliance audit process under the aegis of the auditor who's responsible for signing it off.

MR RASSI: Of course. That is possible and yes, if I was operating in a small firm and maybe in a remote area, I would probably have to rely on that type of formula if I didn't have the expertise myself. If I was a general practitioner in a remote area I may have to call on external help to enable me to sign off that report. At the end of the day I wouldn't do anything that I wasn't skilled to do or, on the other hand, I wouldn't undertake jobs that I didn't have adequate resources to enable me to complete that job. So yes, that is possible. I certainly don't see the need for it, you know, in the cities and with the bigger firms. Having said that, if I had a situation with any of my audit clients where I needed to seek legal advice on particular aspects of compliance I would do so. But that would be a rarity, in my experience.

MR FRENEY: Does the act actually preclude this sort of practice happening now?

MR RASSI: No, it doesn't.

MR FRENEY: It doesn't actually, does it?

MR RASSI: Not at all, no. But I remain responsible for the opinion that I express on that whole process. So I can use who I like, but at the end of the day it's my opinion that goes on the accounts. I sign the audit report. I take responsibility for whatever staff work for me or indeed external consultants, if I had to use external consultants.

MR FRENEY: So what would your view be of non-authorised or approved accountants being able to sign off on a compliance audit?

MR RASSI: Yes, I would be opposed to that. I think, on face, I would be opposed to that, just for the reasons that I gave earlier, that when you're confronted with a large fund with lots of transactions going through it, it's the audit techniques and methodologies that are very important there in terms of arriving at some sort of conclusion on the overall population, because we all know that it is impossible to look at 100 per cent of all the dealings of a particular fund in a year and that's where the skills of the audit profession comes in, being able to dissect, analyse, identify where the risk areas are and then zero in on those, and then extrapolate a conclusion over the overall operation.

MR FRENEY: So there is a particular skill?

MR RASSI: There is.

MR FRENEY: Is there training that is peculiar to the accounting profession that - - -

MR RASSI: I believe so.

MR FRENEY: - - - for example the legal profession wouldn't have, that would enable it to perform that work satisfactorily.

MR RASSI: Certainly in becoming a chartered accountant I've had to do the normal commerce degree which included auditing, specific auditing training, and on joining the firm I had to undertake extensive training in the firm's audit methodology - and every firm tends to have its own proprietary audit methodology and that's years of training, and it really takes, like, a number of years to become a seasoned auditor. Then when you go to the Institute of Chartered Accountants to become a chartered accountant, again there's extensive training on auditing.

So it is a skill that's acquired over time with specific directed training and learning and it's not something that you can just walk into and acquire in an ad hoc way, and I don't believe that lawyers for example would undertake that type of training, certainly not in auditing. You may have some lawyers that have got double degrees that may have done some limited work in that area at in the university but that would be about it, and I think that's where we really are quite different to other

professional groups. It's in that audit skill, that investigative skill that's required to perform the task at hand.

MR FRENEY: So legal knowledge of the SIS Act and its provisions and requirements and legal knowledge of the operations of a superannuation fund, by virtue of the fund being a client of that law firm, wouldn't be sufficient to enable that firm to - - -

MR RASSI: Sign off an audit compliance.

MR FRENEY: - - - sign off on a compliance audit.

MR RASSI: Right now at present, knowing the type of work that lawyers do, I would have to say no. If specific training was introduced for such practitioners, yes, they would be able to acquire those skills, just like anyone else would be able to acquire new skills.

MR FRENEY: Thank you.

MR COSGROVE: If a legal firm had someone trained, as you have been trained, would you take the same view? In other words, they would have in-house expertise to do the appropriate sampling of returns and so on, but that nevertheless the legal partner rather than that supporting accountant would sign off. Would that still worry you?

MR RASSI: I mean, if we look at the requirements as they stand, the compliance and the financial statement requirements are together in the one report. There is no way that the lawyers are going to be able to do the financial statement bit that's required in that audit process. That's the part that I can't put my mind around. You know, if you disaggregate that process we can get to the situation where lawyers can be up-skilled and sign off some sort of a compliance report for that entity. But let's not forget that at the moment the audit process is a combined one and there's one report that gets signed, both on the financial statements and compliance with SIS.

MR COSGROVE: So each audit essentially begins as soon as the financial accounts become available? You do both the financial audit and the compliance audit.

MR RASSI: In an integrated process.

MR COSGROVE: Yes.

MR RASSI: Integrated. It can be disaggregated.

MR COSGROVE: Yes.

MR RASSI: But at the moment it's integrated and there's only one report.

MR FRENEY: And one sign-off.

MR RASSI: And one sign-off. You disaggregate it. You've got two different parties involved. You've got additional cost.

MR FRENEY: That's what I'm saying.

MR COSGROVE: Thank you. You have taken a fairly liberal view, one might say, about the treatment of benefits accruing to genuine non-residents, short-term non-resident employees in Australia. Draft recommendation 5.2, you say you'd like to see that suggestion widened to enable all benefits which relate to a national of a foreign jurisdiction to be repatriated.

MR RASSI: Yes.

MR COSGROVE: "Where the country" - that is, the foreign country I assume - "enables individuals to make voluntary contributions to a regulated pension scheme subject to preservation rules."

MR RASSI: Yes.

MR COSGROVE: I was wondering though whether in this situation such a - admittedly short-term non-resident. Something hangs of course on the word "short-term" but they might be able to accrue, particularly if they were at the higher skilled end of the workforce, some substantial tax advantage Australian contributions which then go out tax advantaged and, you know, they seem to be winning in each situation there, in Australia and in the overseas country. We're not really allowed by our terms of reference to be engaging in taxation matters, as you know.

MR RASSI: No.

MR COSGROVE: But this is a recommendation which I think we qualified, or did we - seemingly not. Of course we had a limit, yes, and the purpose of that limit, in our eyes, was to constrain the possible abuse of taxation concessions available. Are you worried at all on that score, as we were?

MR RASSI: No. Look, I didn't really focus on the taxation benefits side of it. But as a concept, working for an international firm, seeing people come from other countries come and go, I just don't think it's right and it causes as lot of administrative headaches for a number of funds, to have all these accounts for people that don't even live in the country any more. It can add to the cost of all remaining members.

MR COSGROVE: I agree.

MR RASSI: Particularly if those accounts are subject to member protection and the cost of member protection is being borne by who is left. In a lot of cases there will be accounts that will be subject to member protection and I just think it adds another layer of administration that we can do without. I just find it as a matter of principle, a difficult principle to deal with in my mind that someone comes across here, works for a year or so and then has to leave an account behind in Australia. It just doesn't make a lot of sense to me. I didn't focus on the taxation part of it and maybe there might be a way of actually dealing with that aspect to allow the benefit to disappear overseas.

MR FRENEY: Could I ask while we are in this area, in our previous recommendation, Richard, 5.1, where we were addressing the question of employment status and age and your comment on that is that you would support simplification of these provisions - - -

MR RASSI: Yes.

MR FRENEY: - - - to ensure the measurement of employment and other tests are consistent and practical. I apologise if we have been over this ground with you before, but from our perspective what would the potential cost savings be to superannuation funds from simplification in this area? Is it a significant cost impact to them and if so, what kind of funds in particular?

MR RASSI: I think it tends to affect the larger funds such as the public offer funds and the industry funds more so than the corporate superannuation funds, because in the corporate environment of course you have a much better handle of who your contributors are, but in an industry fund you don't. For them it is another administrative task to ensure that the fund is able to accept those contributions. To put a dollar amount on it I really couldn't tell you what that dollar amount is, but I think it is substantial enough to warrant simplification and for something to be done in this area. But I really couldn't put a dollar amount on it and maybe someone from the administration industry might be able to put some costings around it. But I know it is a constant battle for them, because they have to under the law continually confirm the conditions for acceptance of those contributions and that is costly.

MR FRENEY: No doubt you must see signs of that in our auditing of their processes, so that you see the kinds of systems that they have to have in place to be checking these, particularly as you say more remote trustees and administrators.

MR RASSI: Yes, but often the system is as simple as let's write back to this particular employer and confirm that this individual is working X number of hours and take it from there. So there is a lack of sophisticated systems out there to deal with this issue I have to tell you. In some cases requirement is not being addressed properly. But for those that are addressing it and doing it properly, it is just another cost that I think we could probably do without or the industry can do without. But I

can't put dollars on it, sorry.

MR COSGROVE: The next one we are interested in, Richard, is your reaction to draft recommendation 7.1 and of course we fully understand what you had to say earlier about let's get this all sorted out in some coordinated way.

MR RASSI: Yes.

MR COSGROVE: We quite agree, however, that may not happen. I'm not yet fully au fait with the requirements contained in what is now the Financial Reform Sector Act on this licensing of trustees, but I had the impression that as regards non-approved trustees it was a pretty light-handed type of requirement and I was wondering whether if that is the case whether that is adequate or whether something more might be required.

MR RASSI: You are right, at the first instance when the FSR proposals were tabled, they talked about licensing all superannuation funds. In the latest revisions to that legislation it says that all funds need to be licensed, but ASIC have got a no action policy in relation to non-public offer funds. I believe that is the way it will work. So you are right - - -

MR COSGROVE: That is intended to be a permanent arrangement, is it not? There was a two-year period mentioned at one time.

MR RASSI: That was a transitional arrangement.

MR COSGROVE: This is separate, is it?

MR RASSI: Correct, yes. So there will be a no action policy taken in respect of corporate superannuation funds that don't get licensed. So one would expect that the industry will follow that track and corporate funds will not become licensed. I don't think the answer is in licensing personally. I just am opposed to a framework of licensing. I think the proper measures are to introduce prudential standards for the industry as opposed to just licensing. We can see examples of lots of areas in our daily life where we have licences and you question whether the act of licensing something or someone is effective. If you take the simple example of a driver's licence, does the act of licensing itself improve the standards of driving, or is it the education and the experience and the special courses that drivers take from time, the relevant measures?

MR COSGROVE: I guess it's both, but would you be happy to let a 17-year-old on the road without having had some sort of test? I know they used to do it in Belgium, I'm not sure whether they still do.

MR RASSI: I am just not sure how this licensing would actually screen out or identify the problems, but I think there needs to be more emphasis on actually

identifying who the funds are and having some prescriptive - not detailed prescription, but some prudential standards for those funds to follow would be my preferred course of action.

MR COSGROVE: I don't know whether you have focused in any detail on what we had suggested in this area. It was not we thought terribly demanding, but we did have any fund having to carry some working capital. Beyond that we simply wanted the trustees to be able to demonstrate that they had the capacity to manage a fund and that they could put forward some sort of sensible investment strategy using independent auditors and complaints bodies and so on.

MR RASSI: And that would decide conditions for licensing?

MR COSGROVE: Yes. Does that still seem unattractive to you?

MR RASSI: No, it is not unattractive, but I think it needs to go further - I think it needs to be backed up with prudential standards to make that whole thing effective and I think those three conditions that you have just outlined are not sufficient in themselves to strengthen the industry and the framework.

MR FRENEY: I guess at the moment there is no sort of licensing requirement or anything initially that lifts the consciousness of people who are wanting to become trustees of non-approved trustee public offer funds to being conscious of the sort of things that you are saying and to give some credence and effect to the sort of things that you are saying. So one of the virtues of the licence system is that whether or not it produces high calibre trustees, it would go some way further to heightening consciousness and some sort of commitment to fulfilling the duties diligently and perhaps lifting governance type consciousness that the current system doesn't provide. So they would be some of the virtues of it that you would see it important to go further.

MR RASSI: Yes, I think so. I think you need to also have a series of standards there that prescribe what the appropriate prudential standards are and that could be dove-tailed in with licensing. But can I make a really important point with licensing. You talk about non-public offer funds, don't forget we have for public offer funds a type of licensing in the sense that the approved trustee needs to be licensed to become an approved trustee. There is no growth in non-public offer funds. I mean there is no new corporate funds for example coming in on the market. They are reducing the numbers. There are no new players.

MR COSGROVE: There is still a fairly high stock of them though.

MR RASSI: Yes, there is

MR COSGROVE: And you might conceivably want to apply some stronger arrangements to that stock - - -

MR RASSI: To the funds that are left.

MR COSGROVE: - - - rather than just focus on new ones, of which there may well be none as you say.

MR RASSI: I haven't seen any new ones for a long time.

MR COSGROVE: The next one that you have commented on really is the Superannuation Complaints Tribunal recommendation. It was the second part of your reaction there that I think we are interested in, Richard, and that is the tribunal's scope is wider than that of an industry operated scheme and its decisions are binding on insurers. It raised a question in our mind of couldn't you apply those same aspects of the tribunal's present field of operation to an industry scheme? It would have to be done I guess through the ASIC policy statement of 139 I think it is, which shows - - -

MR RASSI: If it could be done that way, yes, we would be in support of that. That is such an important element of that whole scheme and the operation of that scheme.

MR COSGROVE: Yes, it is.

MR RASSI: It is terribly important and if that was lost we would not be in favour of that at all, but if it can be carried through we would be fully supportive.

MR FRENEY: Sorry, can I just get that a bit clear. You said if the latter part of your comment could in fact be given effect to through ASIC policy statement 139 for example, then you would be supportive of not having an SCT?

MR RASSI: Correct, and having an industry-based - - -

MR FRENEY: I just wanted to clarify that.

MR RASSI: Yes.

MR FRENEY: Thank you.

MR COSGROVE: I was wondering about whether you could help us a little on recommendation 9.1 about the failure situations. You support the recommendation but you would seek its expansion to require the criteria to be clearly stated to avoid uncertainty about the provisions and when they are to be utilised. That is something which we went a certain way towards, but again, to really delve into the detail, do you have any suggestions at all in that area?

MR RASSI: I can't say that I have spent a lot of time thinking about the detailed criterion, but I think it is just important for the industry to know how it would work and to encourage I suppose a fair and equitable treatment to funds of that situation.

The last thing we need is to have a run of funds seeking compensation for various different or for poor decision-making by trustees.

MR COSGROVE: Indeed.

MR RASSI: So I think the criterion is to be carefully considered and developed to protect the operation of such a system.

MR COSGROVE: So you are looking for a narrow application?

MR RASSI: I think so, yes, and it should be one of these measures of last resort. So it needs to be fairly tight and strict and clear.

MR COSGROVE: The next matter I think concerns the ever present topic of lodgment of annual returns, of which you have had quite a bit to say on and that is material we will need to look at in more detail when we have time. There is one statement there based on your discussions with members which interested us. You have said there one trustee has spent up to $450,000 on temporary staff to prepare accounts. Is that a very large trustee, looking after a lot of SAFS for example?

MR RASSI: Yes, definitely. It would be really at the top end.

MR COSGROVE: The second one, the unlisted trusts point. Yes, that interested me. I think you mentioned earlier that tax and contributions information together with investment valuation and distribution details for investments in unlisted trusts in many cases will not be ready in time.

MR RASSI: Yes.

MR COSGROVE: When does that sort of information typically become available from unlisted trusts?

MR RASSI: It can be up to three months after the end of the financial year, which is one of the serious problems that confronts the industry and it's one of the reasons why a lot of funds end up going into pooled superannuation trusts or corps law investment trusts as opposed to having investments in unlisted type products. The information flow can be a real problem.

MR COSGROVE: Even from large investment funds managers?

MR RASSI: Yes, absolutely, sure. I particular it's usually the tax information because the tax information always comes last in the process and that can be months after year end and when that happens it really squeezes the entire reporting process and squeezes the audit process as well. So the administrator can't complete the accounts. We can't go in there and finalise the audit. It's a real issue in some segments of the industry.

MR COSGROVE: Why is it that you think APRA seems not to be cognisant of that type of problem? Our impression is that they're really pretty determined about implementing this four-month return.

MR RASSI: They have, yes. Yes, they are adamant about the four-month lodgment. I think they believe it's do-able. I think they're wanting to create a regime where information from funds is obtained as quickly as possible as the basis to enable them to identify problems in the industry so that comes into it. So they're needing timely information.

MR COSGROVE: And I suppose from the super fund members' interests it's valuable as well to know.

MR RASSI: Correct, sure, but I think there are alternatives to address this particular problem. I mean, it's a horrendous industry to work in. I've got to tell you that as national partner in charge of our superannuation practice most of the people working for me have worked 14 to 16-hour days for the last month and that creates an enormous pressure on practitioners and everyone associated with the industry for the sake of deadlines. I think a more sensible approach might be to use an Australian Tax Office type model where you have watchman programs and you have a staggered type program. You know, even a simple move like, "Let's shift all the small APRA funds to an automatic 31 December reporting cycle," would shift hundreds and thousands of funds off that 30 June cycle and spread the work out a little bit.

That would have a number of advantages: (a) it would mean that people wouldn't have to bring in expensive resources to get over the deadlines; (b) it means that the quality of the information that's being generated and the quality of the audit process improves.

MR COSGROVE: Is this a problem principally for the small firms, including small corporate funds as well as SAFs?

MR RASSI: It's a problem in the sense that all funds regulated by APRA have the same - - -

MR COSGROVE: Yes, I guess what I was getting at was is it easier for a large retail fund to have its information audited and ready to go to APRA by the end of October than it is for a smaller one?

MR RASSI: It's the same for all funds but when you put them all together it creates a numerous problem for the administrators that are putting the year-end reporting packages together. It really is no different in terms of a small fund versus a large fund. They all have to get certain basic information in the door to enable them to close off the books, to enable the audit process to take place. So I don't think that is

the issue. I think it's the issue that everything is bunched up and there's an enormous concentration of reporting in one period of the year.

MR COSGROVE: Is the institute and other similar bodies - I should have perhaps asked ASPA for example about this - are they putting pressure on the unlisted trusts and other investment managers who are slow to provide this?

MR RASSI: Yes, I've got to say that clients generally - when I say clients, trustees of super funds have been quite diligent in that area because obviously they can't perform if one of their service providers or their investment managers isn't delivering the information and so they're getting pressure as well from the auditors, from the regulator, you know, in terms of headlines. So trustees have generally dealt with those situations and in a lot of cases it means getting rid of the particular service provider and investment manager. I think the industry is generally - - -

MR COSGROVE: So is there a possibility that the problem that we might have here is transitional, that as some of these practices by the providers of information and the administrators improve you would be able to meet this deadline?

MR RASSI: I don't think that's the total answer to it, I really don't. I just think that the industry on the one hand is encouraging specialisation. It encourages specialist auditors. It encourages specialist service providers to support the whole industry and when you specialise and you encourage specialisation there's only so many people that can go around to perform all of the work that needs to be performed. So bunching it up all around one period of the year is just not a practical framework in my opinion. I think it's putting a lot of undue strain on the whole system and certain aspects of the system, the quality of certain aspects of that year-end reporting which I think is absolutely critical for maintaining accountability to members is being rushed.

MR COSGROVE: If the quality is in some way being compromised as I think you've indicated, that should be of concern to the regulator.

MR RASSI: It should be, I agree.

MR FRENEY: I understand that the annual reporting date is related to the year of income of the fund.

MR RASSI: Correct.

MR FRENEY: The year of income of the funding in another way is linked to the Income Tax Act requirements.

MR RASSI: Correct.

MR FRENEY: But I don't fully understand - my understanding is that the Commissioner of taxation is unlikely to grant any substituted accounting period - - -

MR RASSI: Substituted accounting period.

MR FRENEY: - - - for superannuation funds as a general rule so that it comes back in a sense to this requirement of income tax reporting.

MR RASSI: Correct.

MR FRENEY: You would know a lot more about it than I do, Richard, but I can't help thinking about the corporate company reporting requirements and at one point in history they were all at the one date in the year and then they moved to a system of quarterly company tax collection and with some sort of phasing, I think, of income tax periods. So can you explain to me why there is some sort of rigidity with respect to the income tax year of superannuation funds? I'm just wondering if this is an angle that can be further explored.

MR RASSI: Yes, I honestly believe there is no - I don't think there's a lot of magic about it or science that has gone into it. I think as a general rule I don't think the Commissioner of taxation is very keen on granting substituted accounting periods, not only for super funds but other entities as well unless there are specific reasons for having to do so and I guess it comes down to an issue of - from their perspective - managing the revenues and the administration of the whole system.

MR FRENEY: Their management of the collection of income direct from the superannuation funds.

MR RASSI: Correct, and also I suppose from their perspective it means that if you've got a whole range of different deadlines it makes it more difficult to manage to see where the various things are at. I can't give you any other reasons as to why it's so rigid but you're right. It is very rigid and that's why we've got, you know, 98 per cent of funds with a 30 June income year when I think a lot of funds would be quite happy to move to a different income year if it means getting better attention from service providers; if it means taking the reporting of the super fund away from the corporate year-end reporting cycle which is the other issue of course. A lot of companies have this problem of, you know, everything is falling at the same time - the super fund, the corporate, all these other requirements. So I think it needs to be looked at and I think a sensible approach should be taken to all of that and I think a model of possibly shifting some of the smaller funds to a different year-end I think would benefit the industry.

MR FRENEY: But if the Commissioner of Taxation is say very unlikely to grant such accounting periods would that make your thinking about alternative income years for superannuation funds a dead duck?

MR RASSI: No, because when I raise recommendations for improvement, I would see them as being a party to bringing about overall improvement and we shouldn't

just look at, you know, in - - - They're obviously an important element of the overall system and they need to come to the table and look at it and change the appropriate legislation. I'm just putting on the table what I think is a sensible solution. Yes, if it involves the tax Commissioner then it should involve the tax Commissioner and he shouldn't be excluded from reform.

MR FRENEY: But the link between preparing the income tax returns and the annual income statements for the superannuation funds is a very, very strong link so that you wouldn't really want to be separating that from an accounting profession point of view, would you?

MR RASSI: I think you've got to - - -

MR FRENEY: You've got to do it all at once?

MR RASSI: Correct. I think you've got to do it in an integrated fashion. The last thing we need is for the super fund for accounting and APRA reporting purposes having a December year-end and for income tax filing have a June - I mean, that would add cost to the industry and that would be unworkable from my perspective. You would have to do things in an integrated fashion but I think that would be welcomed by many parts of the industry, that particular model, so that you have, you know, your corporate funds - public offer funds, industry funds on the June - and maybe the small APRA funds and self-managed funds on a different - because as we move forward you will find an increasing number of players in the market looking after all aspects of the industry so you will see one operator looking after small APRA funds. There will be corporate funds in there. There will be public offer funds. There will be the whole range and I think we do need to deal with this issue.

MR FRENEY: Perhaps still in this area, if you will bear with me - it's an important one.

MR RASSI: Yes, it is.

MR FRENEY: Because individual funds and all superannuation funds will get the information from the investment managers late, what you were saying I think is that certain superannuation funds will cope with that better in a reporting sense because they are just individuals and they will be able to engage their accountant and their auditor to get on and probably meet the APRA 31 October deadline. But for certain other funds I think it's particularly the SAFs where there may be one approved trustee entity that was looking after a very large number of funds, that is where the problem particularly lies because of the logistics of getting it all done with relatively scarcer accounting and auditing resources.

MR RASSI: Yes, that's a fair comment.

MR FRENEY: So that brings you back to thinking about the structure and the

capacity of the approved trustee entity looking after all of those SAFs and the accounting and auditing resources that it's engaged in. So the downside from this, if I'm getting into the right area, is using those accounting and auditing resources and perhaps the price of those being bidded up in this one-month period that you've got - or one or two-month period that you've got to meet the - is that the nub of the problem?

MR RASSI: No, the nub of the problem is - well, that's one aspect of the problem but I think the other aspect of the problem is just physically being able to cope with the task at hand, just the physical effort required to deal with the task.

MR FRENEY: By whom?

MR RASSI: By the auditors, by the accountants, by the administrators of the funds.

MR FRENEY: What I can't help thinking is that if it's good enough for most superannuation funds, particularly the larger ones, to meet the APRA deadline, why can't the smaller ones?

MR RASSI: The smaller ones should have the same reporting deadlines as the larger ones, and it's not the issue of making it easier for them. The proposal that I have in mind would be to simply move off the 30 June reporting balance date - move these funds off that date - to a December balance date but still have a four-month reporting cycle. So you're not reducing the reporting cycle, you're not giving them extra time to comply with it, you're just changing their reporting cycle, so instead of their year ending 30 June and having four months to report, their year end ends 31 December and they will have four months up to the end of April to report. From the administrators and the service providers you are shifting the quantity of work over the year. It's not being concentrated at one period over the year.

MR FRENEY: Will the investment managers be able to give them the relevant - - -

MR RASSI: Absolutely. The investment manager's report must be - - -

MR FRENEY: But the tax information - - -

MR RASSI: Yes, no problem.

MR FRENEY: It's all done as of 30 June now.

MR RASSI: Correct. Yes, it could be done in December - not an issue.

MR FRENEY: So on your model it would have to be done as at 30 September.

MR RASSI: Not an issue. That's easily done. That information is available at any time of the year. It's just aggregating a different 12 months to get to that information.

So if the income year is 31 December, no problem. Investment managers produce and analyse the returns monthly and they know what the tax position is on a monthly basis, okay?

MR FRENEY: Or at any point a withdrawal of entry, I assume, so that the calculation can be made.

MR RASSI: Not an issue. That's what I'm proposing, just talking about spreading the workload. That's all I'm talking about.

MR FRENEY: Thank you.

MR RASSI: It would be different if the proposal was, "Let's give them nine months to lodge an annual return from 30 June." That would be different. That would be too generous, and we fall back to the old days where funds had nine months to lodge their return and by that time the fund has gone under and the information so out of date it's of no value. This is a different proposal. It's just shifting physically the whole cycle but still maintaining a four-month turnaround cycle.

MR FRENEY: Which could be accommodated by the market but which essentially comes back to this link with the income tax reporting requirements.

MR RASSI: Correct. That would need to come into it. To really make it effective and to pull that off the tax - - -

MR FRENEY: And without that it really wouldn't be worth - - -

MR RASSI: I don't think it would work without that.

MR FRENEY: No. Thank you. Thanks, John.

MR COSGROVE: That's it? Thank you, Richard, for bearing with us.

MR RASSI: No, that's okay. That's good. I'm glad you're clear on what I'm arguing.

MR FRENEY: Yes, we are.

MR COSGROVE: We don't have any further questions. Is there anything else you wanted to say to us?

MR RASSI: No, not really, other than to maybe highlight some of the comments we've made on removing duplication of compliance. Increasingly I'm faced with looking after large organisations that administer and look after SIS-regulated products side by side with MIA regulated products. It's a bit of an artificial distinction that's been drawn between those types of operations when really when

one analyses the nature and function of those products there's a lot of similarities. That is increasing the cost of compliance because you're virtually creating two compliance frameworks and regimes within the one organisation. So going forward I think there needs to be an overarching compliance framework put in place.

MR COSGROVE: There are a lot of policy objectives of course involved in this whole area and we can see that there might be scope for that kind of rationalisation to some extent, but you've still got some sort of leftover bits related to retirement incomes policy that would have to be complied with separately.

MR RASSI: Yes, sure. It's complex.

MR COSGROVE: Yes. Again I guess it's not possible for you to give us any quantitative indication of the extent of the costs resulting from this duplication?

MR RASSI: Look, I haven't done an empirical studies into this but if I had to give you an off-the-cuff estimation of what I think the savings might be, you could be talking about 10 to 20 per cent cost saving to the organisation involved, because at the moment they do. They've got compliance plans for MIA, no compliance plans for superannuation funds, risk management statements for superannuation funds, no risk management statements for MIA regulated products, a different audit process for the SIS products to that of the MIA, different regulators involved. It's creating two separate - - -

MR COSGROVE: You mean 10 to 20 per cent of the total costs?

MR RASSI: No, 10 to 20 per cent of their cost of meeting compliance.

MR COSGROVE: Compliance, yes, okay.

MR RASSI: Yes, which is quite a significant element of their overall costs. At the end of the day all of these funds are backed by substantial compliance type resources, so that is a significant number and one should do a study into that at some point.

MR COSGROVE: This, you're suggesting, would require I suppose the replacement of at least two regulators with one, which is another issue that would need to be addressed.

MR RASSI: Possibly, yes. So I am very much aware that some of the recommendations or concepts that I am putting forward are not easy ones and do require a lot of legislative work to make them happen, but at the end of the day we should aim at a high point. We should aim towards what we believe is the appropriate model going forward for the industry. It might take years to get through some of this stuff, but I think it's important that we continue to discuss it and review it and try to simplify and reduce the costs of the industry to benefit all the investors and members.

MR COSGROVE: Okay, thank you. Is that it so far as you're concerned?

MR RASSI: I should just note that the Senate select committee report on auditing superannuation funds has issued and there are a number of very strong recommendations contained therein. I have to say that as a member of the Institute of Chartered Accountants I think we've agreed with all recommendations bar one and I think they are very positive, and if they're followed through it will certainly improve and strengthen the framework. But I should note that some of those initiatives will in fact add to the cost of auditing superannuation funds. So I make that point and raise that point for noting, but I think it's a beneficial - I know your key emphasis is looking for reducing the cost of compliance but there is a real example there where I think there is a need to strengthen the audit process for superannuation funds which are out of line with other segments of the financial services industry, particularly out of line with the banks, particularly out of line with approved depositing taking institutions, where the auditors of those organisations have some very clear scope to report on risk management statements, which is not currently the case with super funds.

MR COSGROVE: Okay. I'll look at that. Thank you again for providing us with some ideas on this inquiry. That concludes are scheduled proceeding for today but I'll provide an opportunity for anyone else who wishes to make any comments to do so before we close. If not, we're closed and we'll resume our hearings in Melbourne on Tuesday, 30 October. Thank you.

AT 4.54 PM THE INQUIRY WAS ADJOURNED UNTIL
TUESDAY, 30 OCTOBER 2001

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