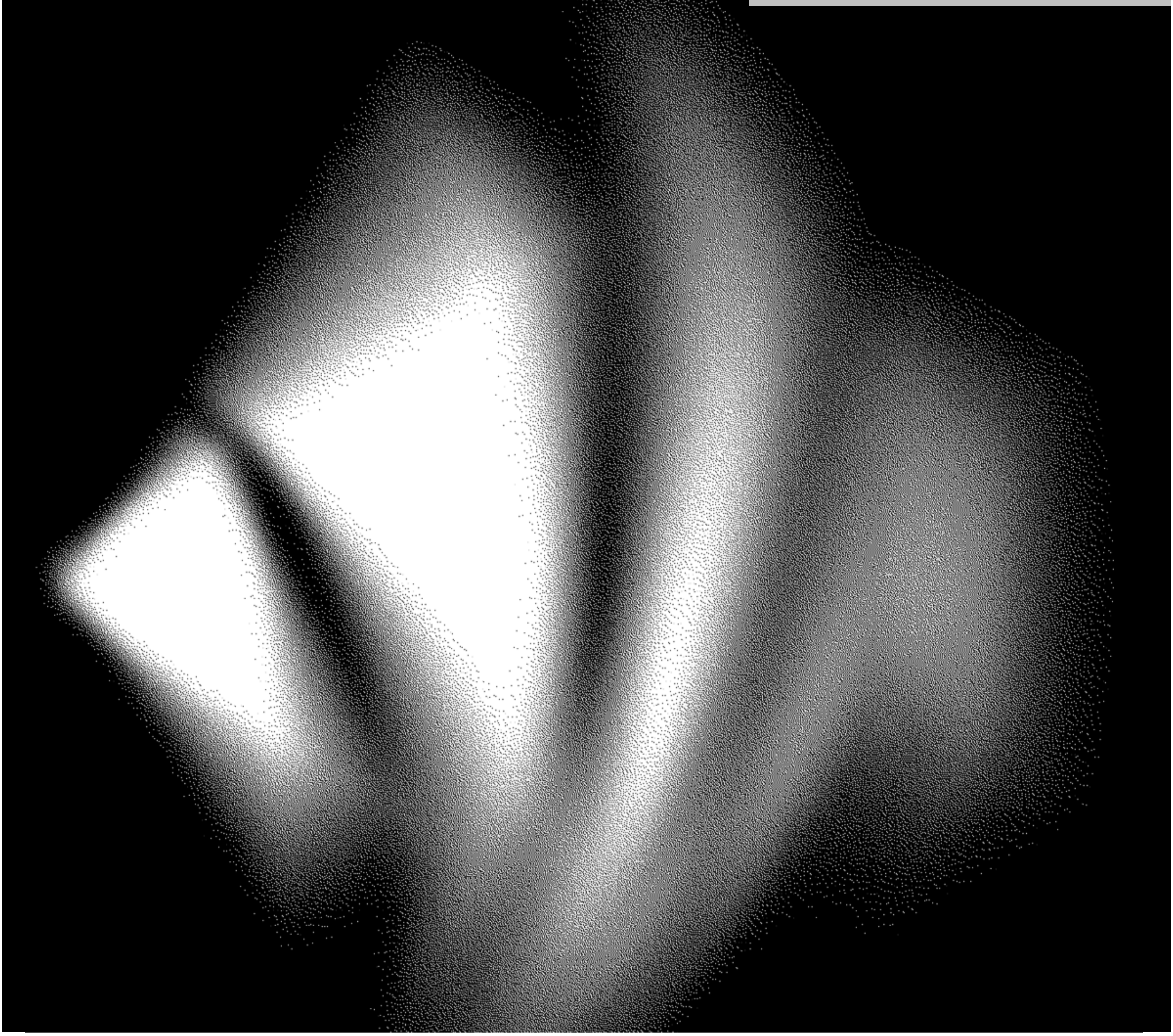
Review of the *Superannuation Industry (Supervision) Act 1993* and Certain Other Superannuation Legislation

PRODUCTIVITY COMMISSION

Inquiry Report

Report No. 18
10 December 2001



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The Productivity Commission

The Productivity Commission, an independent Commonwealth agency, is the Government's principal review and advisory body on microeconomic policy and regulation. It conducts public inquiries and research into a broad range of economic and social issues affecting the welfare of Australians.

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PRODUCTIVITY COMMISSION

10 December 2001

The Hon Peter Costello, MP
Treasurer
Parliament House
Canberra ACT 2600

Dear Treasurer

In accordance with Section 11 of the *Productivity Commission Act 1998*, we have pleasure in submitting to you the Commission's report on the *Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation*.

Yours sincerely

John Cosgrove
Presiding Commissioner

Roger Freney
Associate Commissioner

Terms of reference

I, ROD KEMP, Assistant Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998*, hereby refer the attached list of legislation and associated regulations, relating to superannuation, to the Commission for inquiry and report within 9 months of receipt of this reference. The Commission is to focus on those parts of the legislation that restrict competition, or that impose costs or confer benefits on business. The Commission is to hold hearings for the purpose of the inquiry.

Background

2. This review fulfils a commitment made in the Commonwealth Legislation Review Schedule to undertake National Competition Policy reviews of these Acts. This review will not be addressing taxation issues affecting the superannuation industry, other than levies referred to in the attached Schedule.

Scope of Inquiry

3. The Commission is to report on appropriate arrangements for regulation taking into account the following:

(a) legislation/regulation which restricts competition should be retained only if the benefits to the community as a whole outweigh the costs; and if the objectives of the legislation/regulation can be achieved only by restricting competition. Alternative approaches which may not restrict competition include quasi-regulation and self-regulation.

(b) in assessing the matters in (a), regard should be had, where relevant, to effects on the environment, welfare and equity, occupational health and safety, economic and regional development, consumer interests, the competitiveness of business including small business, and efficient resource allocation.

(c) the need to promote consistency between regulatory regimes and efficient regulatory administration, through improved coordination to eliminate unnecessary duplication.

(d) there should be explicit assessment of the suitability and impact of any standards referenced in the legislation, and justification of their retention if they remain as referenced standards.

(e) compliance costs and the paper work burden on small business should be reduced where feasible.

4. In making assessments in relation to the matters in (3), the Commission is to have regard to the analytical requirements for regulation assessment by the Commonwealth, including those set out in the Competition Principles Agreement. The report of the Commission should:

(a) identify the nature and magnitude of the social, environmental or other economic problem(s) that the legislation seeks to address;

(b) clarify the objectives of the legislation;

(c) identify whether, and to what extent, the legislation restricts competition;
(d) identify relevant alternatives to the legislation, including non-legislative approaches;
(e) analyse and, as far as reasonably practical, quantify the benefits, costs and overall effects of legislation and alternatives identified in (d);
(f) identify the different groups likely to be affected by the legislation and alternatives;
(g) determine a preferred option for regulation, if any, in light of objectives set out in 3; and
(h) examine mechanisms for increasing the overall efficiency, including minimising the compliance costs and paper burden on small business, of the legislation and, where it differs, the preferred option.

5. The Commission should take account of any recent substantive studies relevant to the inquiry.

6. In undertaking the review, the Commission is to advertise nationally and consult with key interest groups and affected parties.

7. The Government will consider the Commission's recommendations, and the Government's response will be announced as soon as possible after the receipt of the Commission's report.

ROD KEMP
7 FEB 2001

[reference received 7 February 2001]

Schedule

The following Acts and their associated Regulations are to be reviewed:

- *Superannuation (Self Managed Superannuation Funds) Taxation Act 1987*
- *Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition Act 1991*
- *Superannuation (Resolution of Complaints) Act 1993*
- *Superannuation Industry (Supervision) Act 1993* – excluding provisions dealing with:
  - those aspects of the regulation and supervision of self managed superannuation funds that were covered by Superannuation Legislation Amendment Act (No. 3) 1999 and subsequent Regulations;
  - the superannuation investment rules (section 66 and Part 8 of the Act); and
  - matters covered by the draft Financial Services Reform Bill (previously CLERP 6).
- *Occupational Superannuation Standards Regulations Applications Act 1992*
- *Superannuation (Financial Assistance Funding) Levy Act 1993*

Acknowledgments

The Commission wishes to thank the people and organisations which provided valuable information and views on issues covered during the course of the inquiry.

Commissioners also express their appreciation of the professional assistance which they received from the staff who worked on the inquiry.

Contents

BOXES

FIGURES

TABLES

Abbreviations

ACTU	Australian Council of Trade Unions
AIST	Australian Institute of Superannuation Trustees
APRA	Australian Prudential Regulation Authority
ARISA	Australian Retirement Income Streams Association Ltd
ASFA	Association of Superannuation Funds of Australia
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
BIO	Banking Industry Ombudsman
ERF	Eligible Rollover Fund
FICS	Financial Industry Complaints Service
FSR Act	*Financial Services Reform Act 2001*
IEC scheme	Insurance Enquiries and Complaints scheme
IFSA	Investment and Financial Services Association
Jacques Martin	Jacques Martin Industry Funds Administration Pty Ltd
MIA	*Managed Investments Act 1998*
OSSRA Act	*Occupational Superannuation Standards Regulations Application Act 1992*
NTA requirement	net tangible assets requirement
RMS	risk management statement
SG	Superannuation Guarantee
SHAR	Superannuation Holding Account Reserve
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SISFA	Small Independent Superannuation Funds of Australia
SMSF	self-managed superannuation fund
SSCS	Senate Select Committee on Superannuation

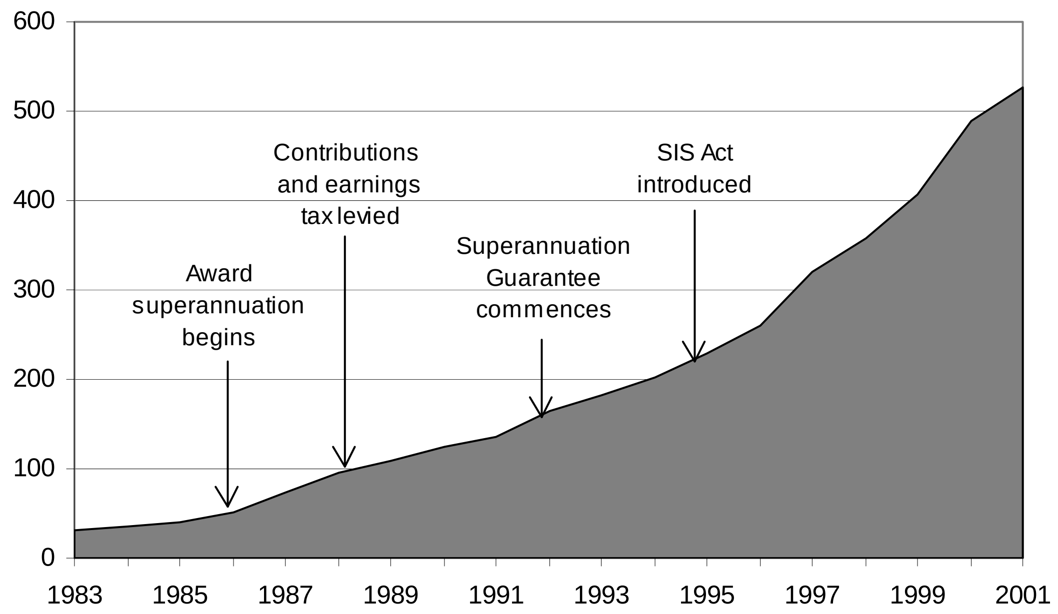
Key messages

- Superannuation savings are growing rapidly and now amount to more than $500 billion. Most of the workforce is covered by superannuation. The community therefore has a strong interest in the prudent management and supervision of superannuation funds.
- The main legislative framework to help ensure that funds are well managed for members is provided by the *Superannuation Industry (Superannuation) Act 1993* (SIS Act). The Act is voluminous, complex and in some respects overly prescriptive.
- Overall, however, the Act provides an effective framework for the prudent management of fund members' interests.
  - Most parts which restrict competition are warranted in order to confine the execution of certain tasks to suitably qualified professionals (for example, actuaries and auditors).
- A number of provisions of the Act impose significant compliance costs on fund members, trustees and others. Examples include complex rules relating to the age and employment status of contributors and to when benefits can be paid, and arrangements for the protection of small accounts and lost members.
  - Some of these provisions should be modified to achieve the legislation's objectives in more cost-effective ways, provided that scope is not created for abuse of taxation concessions.
- The Commission's preferred option is to amend the SIS Act with a view to removing unnecessary restriction of competition and to reduce compliance costs, and to enhance licensing of trustees — given their important responsibility in prudent management of members' funds.
- More substantial modification of the SIS Act could involve reducing duplication between it and the Managed Investments and Life Insurance Acts faced by certain providers of superannuation. Another option would be to restructure the SIS Act so that it includes only broad objectives and powers, with greater reliance on regulations and explanatory guidelines to specify the operating standards.
  - These options, while offering scope for improvement to some in the industry, are not without difficulty. However, the legislative duplication should be reviewed in order to reduce compliance costs faced by providers of retail investment products and life insurance companies.
- The Commission recommends, on balance, that the Superannuation Complaints Tribunal legislation be replaced by a more flexible and cost-effective requirement that funds belong to an approved independent industry-based dispute resolution scheme.
- More transparent arrangements should be put in place for possible provision of assistance to funds seriously affected by fraud or theft.

Overview

Since the early 1980s, assets under management in superannuation funds have increased from around $30 billion to more than $500 billion in 2001. These assets now comprise 15 per cent of private sector wealth. The rapid growth in superannuation assets is mainly the result of the introduction of award-based contributions in 1986, together with the requirement since 1992 that employers make contributions to funds on behalf of their employees under the Superannuation Guarantee Scheme. Those compulsory contributions will shortly amount to 9 per cent of employee earnings. In addition to compulsory contributions, the assets under management have been augmented by voluntary contributions (stimulated by tax concessions) and by re-investment of the returns on the investments.

Figure 1 **Superannuation assets, June 1983 to June 2001**
($ billion)



Source: APRA (2001k).

An important consequence of these developments is that virtually all employees now hold some superannuation assets. The extent of superannuation coverage of self-employed people is much less, but is also increasing. Member account balances average $23 000, but they differ widely across the various types of funds.

While superannuation saving has grown, there has been little change in total household saving. Superannuation appears to have displaced other forms of saving by households and been accompanied by increased household wealth and higher borrowing.

Industry structure

Superannuation contributions can be made to a diverse range of funds. These include corporate funds, industry funds, public sector funds and retail funds, as well as small funds (with membership of fewer than five people). They provide a variety of superannuation products. The great majority of funds are small self-managed funds regulated by the Australian Taxation Office (ATO). Other small funds and corporate funds constitute numerically the bulk of the funds regulated by the Australian Prudential Regulation Authority (APRA).

Table 1 **The superannuation industry, June 2001**

Type of fund	*Funds*	*Member accounts*		*Assets*	
	No.	'000s	% of total	$ billion	% of total
Corporate or enterprise	3 235	1 570	7	81	15
Industry	139	6 977	30	45	9
Public sector	94	2 846	12	114	22
Retail	274	11 459	49	160	30
Sub-total	***3 742***	***22 852***	***98***	***400***	***76***
Small self-managed superannuation funds	214 686	377	2	85	16
Small APRA funds	8 052	10	-	2	-
Sub-total	***222 738***	***387***	***2***	***87***	***17***
Annuities, life office reserves, etc	na	na	na	39	7
Total	**226 480**	**23 238**	**100**	**527**	**100**

Source: APRA (2001k).

The structure of the industry has been changing continuously. The most notable trends in recent years have been the growth in the number of small self-managed funds and consolidation in the balance of the industry. The number of corporate funds has declined substantially. Many small and medium-sized funds have shifted to master trust arrangements with retail funds. This has enabled them to gain benefits from economies of scale in administration and to increase investment choices available to members, as well as allowing employers to concentrate on their core business activities. Over the last five years, the number of retail funds almost halved. However, about half of all member accounts and 30 per cent of superannuation assets are held in retail funds.

Superannuation Industry (Supervision) Act 1993

As superannuation savings are now growing strongly and are a principal source of retirement income, the community has a considerable reliance on and interest in the prudent management of these assets. Poor investment decisions, or fraudulent conduct of funds, can result in significant losses for affected members — particularly for older people in the workforce or retired people who have little chance to re-establish their retirement incomes.

The Government’s use of a combination of compulsion and incentives to ensure widespread private provision of retirement incomes necessarily requires that the conduct of superannuation entities be regulated by legislation. A non-legislative approach (such as an industry code of conduct) would expose the management of superannuation assets to more significant risks and would be unlikely to be acceptable to the community.

For these reasons, legislation was enacted in 1993 to enhance the framework for the prudent management of superannuation funds, with the operations of those funds subject to prudential supervision by independent regulators. It came into operation in July 1994.

The main purpose of this inquiry is to review that legislation — namely, the *Superannuation Industry (Supervision) Act 1993* (hereafter referred to as the SIS Act).

It is important to note that this inquiry is not a general review of superannuation policy issues; nor does its scope extend to all parts of the SIS Act. The terms of reference preclude the Commission from reviewing taxation matters and provisions of the Act that have recently been subject to regulation review — such as those dealing with the supervision of self-managed superannuation funds, the ‘in-house’ investment rules and provisions covered by the recently enacted *Financial Services Reform Act 2001*. In other words, the Commission’s task focuses on those provisions in the legislation governing the prudent management and supervision of superannuation funds. The Commission has also been asked to review certain other superannuation legislation, which is discussed below.

The SIS Act is a voluminous, complex and somewhat prescriptive document applying to all regulated superannuation entities, largely because it addresses a range of policy objectives. These include retirement incomes policy, market conduct, information disclosure and prevention of abuse of taxation concessions — as well as prudent management and supervision of funds. It is supported by a substantial volume of Regulations. In addition, numerous circulars and other guidance material have been issued by the regulators to clarify application of the SIS Act and Regulations. Frequent amendments to the Act have added to its complexity.

Three regulators — APRA, the Australian Securities and Investments Commission (ASIC) and the ATO — are responsible for administration of the legislation.

Participants' views

Participants were generally supportive of the broad objectives of regulation of superannuation entities, and of the requirements imposed on trustees. Indeed, the need for independent prudential regulation backed by legislation was unquestioned. Many, however, expressed concern about the complex and prescriptive nature of the SIS Act.

On the whole, participants considered that the existing legislation has little effect on competition. Nonetheless, some pointed to particular provisions which they considered either limit competition unduly, or add significantly to compliance costs. Many participants said that the major costs of compliance faced by funds derived from tax-related superannuation requirements not under reference, such as the superannuation surcharge legislation.

Approach to the review

As this is a national competition policy review, the terms of reference ask the Commission to focus on those parts of the legislation that restrict competition, or that impose costs or confer benefits on business (considered for this inquiry to include members and trustees of superannuation funds and those who provide services to them). Legislation which restricts competition should be retained only if the benefits to the community as a whole outweigh the costs, and if the objective of the legislation can be achieved only by restricting competition. Alternative approaches which may not restrict competition, including quasi-regulation and self-regulation, are to be considered in these reviews.

Box 1 **Participants' views**

Association of Superannuation Funds of Australia: Despite the strong support for the conceptual basis upon which the superannuation legislation is premised, ASFA is concerned about a creeping prescription and complexity within the SIS regime and its potential to increase costs and inhibit competition both between superannuation funds and between service providers of superannuation funds. (trans., p. 4)

Australian Institute of Superannuation Trustees: We believe the current prudential regime is effective in protecting superannuation savings. … [the] current compliance and reporting requirements are in general justified. The cost of compliance with SIS is high, and the complexity of the regime imposes heavy burdens on trustees. (sub. 19, p. 2)

Queensland Government Superannuation Office: Whilst the general principles underpinning the SIS legislation are appropriate, the "grandfathering" of certain initiatives, the interaction with other Commonwealth legislation such as taxation and social security, and the distribution of regulatory functions, have all contributed to a more complex regime than was perhaps anticipated. (sub. 41, p. 3)

Industry Funds Forum: We support the current regulatory framework because it represents an appropriate balance between on the one hand the need to protect superannuation fund members' savings and the need for broad community support for superannuation, and on the other hand the need to ensure that whatever regulatory regime that is in place is efficient and facilitates an appropriately competitive market. (sub. 10, p. 1)

PricewaterhouseCoopers: Our general consensus [of a discussion group] is that the Superannuation Industry (Supervision) Act 1993 (SIS Act) is pro-competitive and provides a comprehensive legal framework for the good management of members' interests by Trustees. (sub. 14, p. 6)

Small Independent Superannuation Funds Association Ltd: … the present legislation can be considered to provide a fundamentally sound framework for achieving the broad policy objectives of retirement incomes in Australia. … however, the legislation seems to have become bogged down in too much detail as a result of all the amendments to it. Many of these amendments have only served to introduce restrictions, more prescriptive measures and complexities to the superannuation system. (sub. 13, p. 1)

William M Mercer: Compliance effectively impacts on every transaction in some way or other. Whilst compliance with SIS is a significant issue, compliance for tax purposes is even more significant. By far the greatest compliance issue is the superannuation surcharge. (sub. 8, p. 7)

Options for modifications to the SIS legislation

By and large, the SIS legislation is an effective framework for the prudent management of fund members' interests. Nonetheless, it is complex, lengthy and has been subject to continuous change. As a result, there is reason to consider how it might be improved, including whether comprehensive changes might be justifiable.

Consequently, the Commission has identified four legislative options which could improve the cost-effectiveness of the SIS Act. These are:

1) improve the specific areas of the legislation which either limit competition unduly or add significantly to compliance costs;
2) enhance the licensing arrangements for superannuation entities by changing the conditions to be met by their trustees;
3) remove the need for corporations that are currently complying with the *Managed Investments Act 1998* and the *Life Insurance Act 1995* to comply with relevant requirements under the SIS legislation; and
4) revise the overall structure of the legislation.

The second and third options could be combined with the first, whereas the fourth is of a different nature and would involve more fundamental changes to the SIS legislation.

1 Improve specific areas of the SIS legislation

Under this option, the Commission has considered possible modifications to provisions of the SIS Act which have an impact on competition and compliance costs in the superannuation industry.

Restrictions on competition

The restrictions on competition contained in the SIS legislation are not extensive. Competition in most segments of the industry appears to be relatively strong. Nonetheless, the Commission has identified some provisions which could restrict competition. These are requirements about who can become a trustee, a custodian, an auditor or an actuary to a regulated superannuation entity. The broad objective of the requirements is to enhance the prudent management of superannuation entities for the benefit of members in circumstances where:

- members are not equally represented on the trustee board and the trustee provides the service on a commercial basis;

- custody of the fund's assets is provided by external service providers such as investment managers or independent custodians; and
- specialised expertise is required to undertake auditing and actuarial tasks.

The following table summarises the requirements which can have the effect of limiting the supply of services to superannuation funds.

Table 2 **Selected elements of entry requirements applying to the provision of services to superannuation funds**

Service	*Entry requirements*
Approved trustee of public offer entities, approved deposit funds, or small APRA funds	Approved trustee to satisfy APRA that it: • can perform the duties of a trustee in the proper manner and • has $5 million in net tangible assets (NTA) - in own right (mandatory for small APRA fund) or - as an approved guarantee or - as a combination of NTA and approved guarantee or • agrees to comply with requirements on custody of assets and • meets conditions specified in Instrument of Approval which are tailored on a case-by-case basis and include - at least $100 000 of eligible assets and of liquid assets and - adequate contingency plan and insurance. • responsible officers pass disqualified person test.
External custodianship	Trustee to be satisfied that: • custodian has $5 million NTA or • approved guarantee where sum of it and NTA is not less than $5 million and • responsible officers pass disqualified person test.
Audit: financial and compliance	Approved auditor is: • Auditor General of Commonwealth, State or Territory or • registered auditor under Corporations Law who is associated in a specific manner with a recognised professional body or • approved by regulator.
Actuarial certificates	Approved actuary is: • fellow or accredited member of the Institute of Actuaries of Australia.

The Commission considers that legislative restriction of competition is necessary in most cases in order to confine the execution of certain tasks to suitably qualified professionals. It considers that the costs of the existing requirements which restrict entry are likely to be small.

Nonetheless, some provisions in the Act could be made more effective. For example:

- trustees of all superannuation funds regulated by APRA should be required to prepare and obtain APRA approval for a risk management strategy which addresses the various risks faced in management of the funds, such as operational, financial and governance risks.
- for approved trustees, capital adequacy and liquidity requirements should be amended so that they are linked with the assets under management in a manner similar to the responsible entity requirements in the Managed Investments Act; and
- the requirement that only accountants who have certain qualifications can be responsible for compliance audits should be reviewed.

The net tangible assets requirement for approved trustees should be strengthened through legislative amendment. All approved trustees which use an external custodian should be required to have an amount of net tangible assets (or approved guarantee or combination thereof) that is related to the value of assets under trusteeship, subject to specified minimum and maximum amounts in a manner similar to that required under the Managed Investments Act. Approved trustees which do not use custodians should continue to be required to have $5 million net tangible assets (or equivalent) in their own right.
(Recommendation 4.1)

The eligible and liquid assets requirements for approved trustees should be revised so as to require all approved trustees to have sufficient liquidity. The requirement could be cast in terms similar to that required of responsible entities under the Managed Investments Act. *(Recommendation 4.2)*

All trustees of superannuation entities regulated by the Australian Prudential Regulation Authority should be required to prepare a risk management strategy which addresses the various risks faced in the management of funds, such as operational, investment and governance risks. Trustees should be required to obtain approval of these strategies from the Australian Prudential Regulation Authority and have them audited each year as part of their compliance audits. *(Recommendation 4.3)*

The Australian Prudential Regulation Authority, in conjunction with relevant parties, should review the need to confine the responsibility for a compliance audit to an approved financial auditor. *(Recommendation 4.4)*

The Australian Prudential Regulation Authority, in conjunction with relevant parties, should review the need to confine certain tasks in respect of accumulation

funds to Members or Fellows of the Institute of Actuaries of Australia. *(Recommendation 4.5)*

Compliance costs

Superannuation funds' operations involve administration and investment management costs. These have been declining for several years. The available information indicates that total costs represent around 1.3 per cent of the funds under administration or $200–300 per account per annum. Compliance with the legislation under review comprises a small but not insignificant part of total administration costs. While administration costs have been declining, this does not necessarily mean that the compliance costs have been falling.

The Commission has identified a number of the provisions under review which impose significant compliance costs on fund trustees. These include:

- procedures for verifying the age and employment status of members in relation to contributions and benefit payments;
- provisions protecting small account balances, lost members and non-resident benefits;
- risk management statements; and
- the requirements for certain actuarial certificates.

In each of those areas, the Commission considers that the objectives of the legislation could be achieved by more cost-effective means, although in some cases the possible scope for abuse of taxation concessions would need to be considered.

Contributor status and payment standards

The contributions and payment standards are complex. Trustees and administrators are required to cope with a range of criteria against which the status of fund members must be assessed frequently for both contributions and benefit payments. For example, voluntary contributions can only be accepted if:

- people aged under 65 have worked at least 10 hours in one week over the last two years; and
- people aged between 65 to 70 have worked at least 10 hours in each week.

Voluntary contributions for people aged over 70 cannot be accepted.

Similarly, different employment tests determine when benefits must be paid to people aged between 65 and 70 and those aged over 70.

These requirements add significantly to the operating costs of funds in monitoring contributions and payment obligations, with eventual effects on members' benefits. Modification of the requirements would reduce compliance costs. For example, voluntary contributions up to age 70 could be allowed regardless of a contributor's employment status.

Age and employment requirements governing contributor status and compulsory cashing of benefits should be simplified. The most effective means of doing so would be removal of the employment tests, while limiting any adverse implications for taxation revenue by measures such as reasonable benefit limits and age-based deductible limits. Consideration should also be given to raising the age at which benefits must be compulsorily cashed. *(Recommendation 5.1)*

Benefit protection

Benefit protection applies to small and lost member accounts. The provisions involve significant compliance costs for funds. While of benefit to the account holders concerned, the costs are borne by other fund members. Small accounts with benefits of less than $200 may be cashed out. However, member balances of less than $1000 are to be protected from erosion by fees and charges. This makes account processing and record keeping more expensive. Lost member accounts are also to be protected, regardless of the amounts involved. Currently, there are around 4 million lost member accounts, containing around $5.5 billion.

In both cases, trustees have the choice of either retaining such accounts in the fund or transferring them to another supervised fund which will protect them, such as an Eligible Rollover Fund. Trustees are required, however, to take certain steps to locate a lost member before an account can be transferred.

The Commission finds that protection of small account balances and of lost members is warranted. It considers, however, that compliance costs could be reduced by removing the postal address verification requirements for lost members and the protection of lost member accounts with balances in excess of $1000 (which, in effect, protects them from administration costs in times of low investment returns). The latter change would remove the more favourable treatment accorded to such members than to those with equivalent account balances who are not 'lost'.

The present requirement on trustees to verify the addresses of all lost members should be removed. Protection of lost member accounts with balances in excess of $1000 should also be removed. *(Recommendation 5.2)*

Non-resident benefits

In addition, the balances in non-residents' accounts are required to be preserved. This can involve compliance costs for funds similar to those associated with small and lost member accounts, but which may be higher because the member resides overseas. Typically, these balances accrue to tourists on a working holiday where their employer contributions are paid into a complying Australian superannuation fund. The compliance costs associated with this provision could be reduced by permitting non-residents, on permanent departure from Australia, to obtain benefits that are below a specified small limit. For amounts above that limit, access could be available subject to a taxation adjustment to offset Australian tax concessions.

Superannuation benefits of bona fide non-resident employees below a specified small limit should be available to non-residents on permanent departure from Australia. Amounts above that limit should be subject to a taxation adjustment to offset Australian tax concessions accorded to superannuation.
(Recommendation 5.3)

Risk management statements

The current requirements for risk management statements to accompany the use of derivatives in a funds investment strategy, while warranted as a means of enhancing prudent management, appear to involve unnecessary costs. The specified content of the statements includes considerable technical detail which can make them difficult for trustees to comprehend. These statements are also required to be prepared by trustees even when their investment managers have already done so. The costs involved in meeting these requirements could be lessened by reducing the extent of prescription of content and removing the duplication involved in preparation of risk management statements for compliance audits.

Requirements governing the content of risk management statements related to investment in derivatives should be simplified in order to reduce compliance costs and to sharpen the prudent management focus of trustees. The present requirement that such statements be prepared by both investment managers and trustees for compliance audit purposes should be reviewed in order to remove any unnecessary duplication. *(Recommendation 5.4)*

Actuarial certificates

A number of different types of actuarial certificates are required of superannuation entities, in order to ensure the availability of members' defined benefit and pension payment entitlements. They include funding and solvency certificates for defined benefit funds and the certification of superannuation entities' capacity to pay pensions under the SIS legislation, and valuation certificates of income streams under the deprivation provisions of the social security legislation. Some of the circumstances which are prescribed as requiring such certificates (for example, in the event of significant salary increases for a defined benefit fund which is nonetheless in a very sound financial position) appear to impose unnecessary costs and consideration needs to be given to simplifying them.

The requirements for actuarial certificates should be simplified by the Australian Prudential Regulation Authority, in consultation with the Institute of Actuaries of Australia, the Department of Family and Community Services and the Australian Taxation Office. *(Recommendation 5.5)*

These changes to provisions affecting compliance costs are piecemeal in nature, but they would make it easier for trustees to comply with the objectives of the legislation. They would also help to ensure more prudent management of member interests. Taken together, these compliance cost recommendations would result in benefits to fund members to the extent that lower administration costs augmented the net income of funds. Many participants supported these proposed changes. They attached particular importance to the simplification of contribution and benefit payment rules, and small account balances and lost member requirements.

Other regulatory issues

Lodgment period

In recent years, APRA has requested superannuation entities to lodge audited annual returns with it within four months of the end of the financial year. Previously, corporate and small APRA funds had six and nine months, respectively, to lodge their returns. The purpose of this reduced lodgment period is to enhance prudential supervision of funds by enabling the regulator to identify problem areas more promptly. To date, some 70 per cent of funds have been able to meet the shortened lodgment period.

Many participants expressed concern about the costs of complying with this amended arrangement because of the workload imposed on accountants and administrators in a short period. Nonetheless, there is good reason to apply as short a period as feasible to the lodgment of annual returns. A four-month lodgment period appears appropriate. If difficulties faced by certain funds in complying with this period prove intractable, consideration could be given to means of alleviating the problem, such as by requesting the ATO to allow a different income reporting period for some funds. This would enable the annual workload to be spread more evenly.

Administration of the SIS Act

The administration of the SIS Act is now divided between APRA, ASIC and the ATO following the introduction of new regulatory arrangements for the financial sector three years ago. For some participants, the new arrangements raised concerns about the respective role and responsibilities of the different regulators. It is to be expected that, with the new arrangements based on regulatory function as opposed to type of institution, there would occasionally be uncertainty, inconsistent approaches and possible gaps and duplication. The regulators have taken steps to reduce such problems. Nonetheless, the Commission considers that APRA and ASIC should continue their efforts to improve coordination of their activities, such as site visits, with a view to reducing the additional costs which appear to have arisen.

Exempt public sector superannuation schemes

The SIS legislation provides for public sector superannuation schemes which did not comply with its provisions when it was introduced to be exempt from compliance, but to be treated as complying funds for income tax and superannuation guarantee purposes. The exemption enables the governments concerned to avoid a number of difficulties (such as some funds being unfunded) that they would otherwise face in bringing these schemes into full compliance with the SIS Act.

All governments agreed that they would use their best endeavours to ensure that exempt schemes would be 'treated fairly and equally with their private sector counterparts' and that the Commonwealth Government's retirement income objectives would be met in respect of scheme benefits. However, this has not always been done. Some of the exempt schemes, for example, do not appear to be consistent with the SIS Act's provisions for the preservation of benefits. The Commission considers that steps should be taken to restrict the scope for such divergences from the provisions of the SIS legislation.

There should be no expansion of the current list of exempt public sector superannuation schemes. Consideration should be given by Commonwealth, State and Territory governments to the feasibility of closing exempt schemes which are open to new members and electing to make any new schemes subject to the SIS legislation. *(Recommendation 6.1)*

2 Enhance licensing of superannuation entities

This option would require all superannuation entities to be licensed, and their trustees to meet certain entry and operating standards (such as their capacity to manage an entity and to provide a risk management strategy). Present entry requirements for superannuation funds and trustees are not substantial and raise a question about whether they address adequately the prudent management objective of the legislation.

Superannuation entities are the only part of the financial services sector which are not required to be licensed in a formal manner in order to deal with other peoples' assets. This appears unsatisfactory given that superannuation assets now comprise some 15 per cent of private sector wealth.

While this option would involve some initial increase in administration and compliance costs, and could result in a decline in the number of competitors, it would have significant benefits. By requiring higher standards of trustees, it should enable APRA and fund members to be more confident that superannuation savings are prudently managed. It would also assist APRA to identify more readily the population of superannuation entities. In addition, APRA would be able to target more effectively its supervision of funds to areas of identified weaknesses.

The SIS legislation should be amended to require that trustees of superannuation entities be licensed by the Australian Prudential Regulation Authority subject to specific conditions pertaining to such matters as trustee capacity and the provision of a risk management strategy. The Government and the Australian Prudential Regulation Authority should consult widely on the details of such a licensing arrangement. *(Recommendation 7.2)*

3 Remove duplication of compliance with the SIS Act for certain corporations

This option is intended to reduce duplication between the SIS Act and the Managed Investments and Life Insurance Acts faced by certain providers of superannuation — essentially the large retail funds and life insurance companies. The costs arise mainly from the need for these companies to interpose a trust structure which can complicate significantly their governance arrangements in order to comply with the SIS Act. While there are areas of similarity in these Acts, there are also differences. As a result, the extent of the possible reduction in compliance costs, and the benefits to consumers, are uncertain. Nonetheless, harmonisation of relevant parts of these Acts would bring some benefits.

This option raises a number of issues. For example, it is not clear that the licensing requirements of the Managed Investments Act are as robust as corresponding provisions in the SIS Act. Moreover, there would need to be clear criteria against which to determine which responsible entities should benefit from this alternative. An understanding would need to be reached between ASIC and APRA so that the latter could be assured that entities deemed to have complied with the Managed Investments Act could be accorded compliance with the SIS Act. There would not be such a problem in respect of life offices, which are regulated by APRA.

Duplication between the SIS legislation and the Managed Investments Act should be reviewed jointly by the Australian Prudential Regulatory Authority and the Australian Securities and Investments Commission. The aim of such a review should be to encourage consistency between the two regimes in their application to providers of retail investment products. *(Recommendation 7.3)*

The Australian Prudential Regulation Authority should review the possibility of removing the need for life insurance companies which write superannuation business in their statutory funds to comply with the prudential requirements of the SIS legislation. *(Recommendation 7.4)*

4 Revise the structure of the legislation

This option would involve a fundamental restructuring of the SIS legislation along the lines of what currently applies to deposit-taking institutions under the *Banking Act 1959* and to general insurance under the *Insurance Act 1973*. It would involve a change in the emphasis given to each of the three tiers of regulation — legislation, regulations and explanatory guidelines. The legislation would include only broad objectives and powers, with greater reliance on regulations and explanatory guidelines to specify the operating standards.

This approach would permit more flexible and timely responses by regulators to market developments and would reduce the complexity of the legislation itself. However, it might not reduce overall complexity and compliance costs because the detailed requirements presently contained in the Act would be shifted to the regulations.

Another possible disadvantage would be that, by giving APRA increased discretion to determine standards, the option could contribute to greater uncertainty amongst superannuation entities. Such uncertainty could create problems for a very long-term investment such as superannuation if funds were subject to unpredictable changes in compliance requirements.

The suitability of this option for the superannuation industry, with its large and diverse composition, would also need to be considered. The banking and general insurance sectors have fewer entities and are more homogeneous.

The introduction of the Financial Services Reform Act, which will require consequential amendments of the SIS Act, provides an opportunity to implement this option. However, the Commission does not consider that this would be beneficial overall.

Preferred option

The Commission's preferred option is a combination of the first two, which involve improvements to specific areas of the SIS legislation and enhanced licensing of superannuation entities. These would:

- remove some unnecessary restriction of competition;
- reduce the costs of complying with the SIS Act; and
- facilitate better management of funds and more effective supervision of them.

The result should be some gains in terms of members' retirement income levels and, for the community, more cost-effective regulation of superannuation.

The SIS legislation should be amended to simplify certain complex requirements which impose significant compliance costs, to increase competition amongst providers of certain services to superannuation entities, and to enhance the effectiveness of capital adequacy and other requirements imposed on trustees. Specific proposals for change are contained in the recommendations given above and in chapters 4 and 5. *(Recommendation 7.1)*

The SIS legislation should be amended to require that trustees of superannuation entities be licensed by the Australian Prudential Regulation Authority subject to specific conditions pertaining to such matters as trustee capacity and the provision of a risk management strategy. The Government and the Australian Prudential Regulation Authority should consult widely on the details of such a licensing arrangement. *(Recommendation 7.2)*

The Commission considers that features of options 3 and 4 would probably lead to improvements in the regulatory framework for prudent management of funds. In each case, however, associated conceptual and practical difficulties could outweigh the gains.

Other legislation under review

Resolution of complaints

The *Superannuation (Resolution of Complaints) Act 1993* established a statutory body, the Superannuation Complaints Tribunal, to resolve complaints which cannot be settled between superannuation fund members and trustees. The Commission considers that, as an alternative to reliance on the court system, the Tribunal provides a cost-effective external means for resolving disputes. The Tribunal has wide support within the superannuation industry. It operates independently and transparently, and is accountable to Parliament on an annual basis. It also provides useful information to APRA.

The Commission considers that there is scope to reduce the cost of external disputes resolution through more efficient use of internal mechanisms for handling inquiries and complaints. At present, over half of the written complaints received by the Tribunal are outside its jurisdiction, frequently on grounds that the complaint has not first been considered by the fund's internal complaints processes. This involves avoidable costs and delays. The existing disclosure mechanisms contained in the SIS Act, while requiring trustees to provide fund members with certain information about the existence and functions of the Tribunal, do not oblige trustees to outline the types of complaints identified in the Resolution of Complaints Act as falling outside the Tribunal's jurisdiction.

Trustees should provide members with information about the categories of complaints that are excluded by legislation from consideration by the Superannuation Complaints Tribunal. *(Recommendation 8.1)*

Since the Superannuation Complaints Tribunal was created, several non-statutory industry-based external disputes resolution schemes have developed and been approved by ASIC. Industry-based schemes are required to meet strong minimum standards of independence, integrity and current relevance in order to gain, and maintain ASIC approval.

Against this background, the Commission has concluded, for the following reasons, that ASIC-approved industry-based schemes would provide a more efficient alternative to the Superannuation Complaints Tribunal:

- the regulatory framework with which these schemes must comply means that they have many features equivalent to those of the Tribunal (for example, independence, transparency and provision of information to regulators);

- the time taken by industry schemes to resolve complaints compares favourably with that taken by the Tribunal;
- in some important respects, industry schemes operate more efficiently than the Tribunal. In particular, they use a system of charges on their industry members which creates a strong incentive for them to resolve complaints internally or in the early stages of the external dispute resolution process, with the result that fewer resources are needed to resolve complaints;
- industry schemes also appear to have an advantage in terms of the flexibility of their operations (for example, as regards the response of their budgetary processes to changes in their workload); and
- they are subject to regular independent review.

The fact that the Tribunal's legislation has an advantage for complainants in that it imposes no monetary limit on complaints within its jurisdiction and that any change to existing arrangements for resolution of superannuation complaints would involve some transitional costs do not outweigh the above considerations.

The Superannuation (Resolution of Complaints) Act 1993 should be repealed, subject to some transitional arrangements.

All superannuation entities regulated by the Australian Prudential Regulation Authority should be required to join a disputes resolution scheme approved by the Australian Securities and Investments Commission. This should be mandated as part of the compliance requirements of those superannuation entities.
(Recommendation 8.2)

The Commission does not see that there is a need to be prescriptive about which disputes resolution scheme superannuation entities should join, other than that funds should join an appropriately licensed body. This is consistent with the provisions contained in the Financial Services Reform Act and in ASIC Policy Statement 139, which would promote consistency among such schemes across the financial services sector.

If the recommendation was adopted, the Tribunal would not be precluded from seeking to re-establish itself as an approved disputes resolution scheme with funding being provided directly by industry.

If it was decided to retain the Resolution of Complaints Act, the Commission considers that some aspects of the Tribunal's operation should be modified. In particular, a more incentive-based system for charging for its resolution of complaints should be introduced, there should be discretion to extend the statutory time limit for consideration of appeals on disability payments and discretion should be provided to the Chairperson on the naming of parties to complaints handled by review.

The Superannuation (Resolution of Complaints) Act 1993 should be amended for the following purposes:

- ***to enable the Superannuation Complaints Tribunal to implement an incentive-based system of charging superannuation entities for its resolution of complaints;***
- ***to give the Tribunal discretion to extend beyond one year the time limit for its decision on complaints against trustees' actions on disability payments; and***
- ***to give the Chairperson of the Tribunal discretion to name parties to complaints reviewed by it.*** *(Recommendation 8.3)*

Financing assistance in some 'failure' situations

The *Superannuation (Financial Assistance Funding) Levy Act 1993* provides for the imposition of a levy on certain superannuation entities for funding financial assistance to APRA-regulated superannuation entities that suffer substantial loss as a result of fraud or theft. The Act is closely related to part 23 of the SIS Act, which provides for financial assistance to be made through a Commonwealth grant. The Government is considering some recent applications for assistance made under part 23, but the provisions of the Levy Act have not yet been used. Nonetheless, the Levy Act appears to provide an effective mechanism, if needed, for imposing a levy to finance any assistance given.

The SIS Act requires the Minister to seek advice from APRA when considering a request for financial assistance, and to table that request for advice in the Parliament. It does not require APRA's advice, or the reasons for the Minister's decision, to be tabled.

The Commission believes that the process of deciding whether to grant financial assistance in the event of fraud or theft should be more transparent.

Part 23 of the Superannuation Industry (Supervision) Act 1993 should be amended to require the Minister to table in Parliament, as soon as practicable, the Australian Prudential Regulation Authority's advice and the reasons for the Minister's decision on whether to provide financial assistance to funds which suffer substantial loss from theft or fraud. *(Recommendation 9.1)*

Funding the supervision of self managed superannuation funds

The *Superannuation (Self Managed Superannuation Funds) Taxation Act 1987* specifies that trustees of self-managed superannuation funds are liable to pay a levy on lodgment of their annual returns to the ATO, and sets out related administrative aspects such as penalties for non-lodgment and late lodgment. The *Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition Act 1991* imposes the levy and sets maximum amounts for it and the late lodgment penalty. The Regulations deriving from this Act set the actual amounts currently payable.

The levy collects revenue to fund the supervision of self-managed superannuation funds by the ATO. The ATO monitors and enforces compliance by such funds with the relevant provisions of the SIS Act. This involves receiving and processing annual returns, investigating funds' compliance with the Act and enforcing compliance as necessary.

The Commission considers that it is appropriate for the supervision of self-managed funds to be funded by a levy imposed on them, on a full cost recovery basis, and that legislation is necessary to implement this. The Commission does not recommend any changes to these Acts. It believes, however, that the costing of the ATO's supervision should be fully transparent.

The Australian Taxation Office should publish the component costs of its regulatory supervision of self-managed superannuation funds to ensure public accountability. *(Recommendation 9.2)*

The Occupational Superannuation Standards Regulations Application Act 1992

The *Occupational Superannuation Standards Regulations Application Act 1992* was enacted to overcome uncertainty about the validity of certain regulations made under the *Occupational Superannuation Standards Act 1987* to accommodate the introduction of the Superannuation Guarantee Scheme. It clarified certain circumstances in which contributions could be accepted by a superannuation fund, limited the rate of increase of benefits vested in a member of a fund and established requirements relating to information to be given to an employer contributor and to the regulator. While the Occupational Superannuation Standards Regulations Act was considered to be necessary at the time, it no longer has any application and should be repealed.

The Occupational Superannuation Standards Regulations Application Act 1992 should be repealed. *(Recommendation 9.3)*

* * * * * *

The scope of this inquiry is relatively narrow, focussing for the most part on the legislation governing prudent management and supervision of superannuation funds. During the course of the inquiry, some participants have expressed dissatisfaction that broader issues of superannuation policy (covered by other legislation) are excluded. It has become clear to the Commission that, complex as the SIS Act is, superannuation policy overall is even more difficult for practitioners to implement and for members of the community to comprehend.

Piecemeal legislative changes involve a risk of overlooking connections between various elements of policy and are unlikely to deal satisfactorily with the difficulties faced at present by those supplying and investing in superannuation assets. A more wide-ranging review which considers the above matters in an integrated way would be likely to lead to better design and implementation of superannuation policy and enhanced community understanding of how to use superannuation as a form of saving for retirement income.

Recommendations

Approved trustees

The net tangible assets requirement for approved trustees should be strengthened through legislative amendment. All approved trustees which use an external custodian should be required to have an amount of net tangible assets (or approved guarantee or combination thereof) that is related to the value of assets under trusteeship, subject to specified minimum and maximum amounts in a manner similar to that required under the Managed Investments Act. Approved trustees which do not use custodians should continue to be required to have $5 million net tangible assets (or equivalent) in their own right.
(Recommendation 4.1, p. 51)

The eligible and liquid assets requirements for approved trustees should be revised so as to require all approved trustees to have sufficient liquidity. The requirement could be cast in terms similar to that required of responsible entities under the Managed Investments Act. *(Recommendation 4.2, p. 54)*

All trustees

All trustees of superannuation entities regulated by the Australian Prudential Regulation Authority should be required to prepare a risk management strategy which addresses the various risks faced in the management of funds, such as operational, investment and governance risks. Trustees should be required to obtain approval of these strategies from the Australian Prudential Regulation Authority and have them audited each year as part of their compliance audits. *(Recommendation 4.3, p. 56)*

Auditors

The Australian Prudential Regulation Authority, in conjunction with relevant parties, should review the need to confine the responsibility for a compliance audit to an approved financial auditor. *(Recommendation 4.4, p. 66)*

Actuaries

The Australian Prudential Regulation Authority, in conjunction with relevant parties, should review the need to confine certain tasks in respect of accumulation funds to Members or Fellows of the Institute of Actuaries of Australia.
(Recommendation 4.5, p. 67)

Contributor status and payment standards

Age and employment requirements governing contributor status and compulsory cashing of benefits should be simplified. The most effective means of doing so would be removal of the employment tests, while limiting any adverse implications for taxation revenue by measures such as reasonable benefit limits and age-based deductible limits. Consideration should also be given to raising the age at which benefits must be compulsorily cashed. *(Recommendation 5.1, p. 80)*

Lost members' benefit protection

The present requirement on trustees to verify the addresses of all lost members should be removed. Protection of lost member accounts with balances in excess of $1000 should also be removed. *(Recommendation 5.2, p. 85)*

Non-resident benefits

Superannuation benefits of bona fide non-resident employees below a specified small limit should be available to non-residents on permanent departure from Australia. Amounts above that limit should be subject to a taxation adjustment to offset Australian tax concessions accorded to superannuation.
(Recommendation 5.3, p. 88)

Risk management statements

Requirements governing the content of risk management statements related to investment in derivatives should be simplified in order to reduce compliance costs and to sharpen the prudent management focus of trustees. The present requirement that such statements be prepared by both investment managers and trustees for compliance audit purposes should be reviewed in order to remove any unnecessary duplication. *(Recommendation 5.4, p. 91)*

Actuarial certification

The requirements for actuarial certificates should be simplified by the Australian Prudential Regulation Authority, in consultation with the Institute of Actuaries of Australia, the Department of Family and Community Services and the Australian Taxation Office. *(Recommendation 5.5, p. 105)*

Exempt public sector schemes

There should be no expansion of the current list of exempt public sector superannuation schemes. Consideration should be given by Commonwealth, State and Territory governments to the feasibility of closing exempt schemes which are open to new members and electing to make any new schemes subject to the SIS legislation. *(Recommendation 6.1, p. 136)*

Commission's preferred option

The SIS legislation should be amended to simplify certain complex requirements which impose significant compliance costs, to increase competition amongst providers of certain services to superannuation entities, and to enhance the effectiveness of capital adequacy and other requirements imposed on trustees. Specific proposals for change are contained in the recommendations given above and in chapters 4 and 5. *(Recommendation 7.1, p. 149)*

The SIS legislation should be amended to require that trustees of superannuation entities be licensed by the Australian Prudential Regulation Authority subject to specific conditions pertaining to such matters as trustee capacity and the provision of a risk management strategy. The Government and the Australian Prudential Regulation Authority should consult widely on the details of such a licensing arrangement. *(Recommendation 7.2, p. 161)*

Removal of legislative duplication

Duplication between the SIS legislation and the Managed Investments Act should be reviewed jointly by the Australian Prudential Regulatory Authority and the Australian Securities and Investments Commission. The aim of such a review should be to achieve consistency between the two regimes in their application to providers of retail investment products. *(Recommendation 7.3, p. 168)*

The Australian Prudential Regulation Authority should review the possibility of removing the need for life insurance companies which write superannuation business in their statutory funds to comply with the prudential requirements of the SIS legislation. *(Recommendation 7.4, p. 171)*

Resolution of complaints

Trustees should provide members with information about the categories of complaints that are excluded by legislation from consideration by the Superannuation Complaints Tribunal. *(Recommendation 8.1, p. 182)*

The Superannuation (Resolution of Complaints) Act 1993 should be repealed, subject to some transitional arrangements.

All superannuation entities regulated by the Australian Prudential Regulation Authority should be required to join a disputes resolution scheme approved by the Australian Securities and Investments Commission. This should be mandated as part of the compliance requirements of those superannuation entities.
(Recommendation 8.2, p. 198)

In the event that the *Superannuation (Resolution of Complaints) Act 1993* is not repealed:

The Superannuation (Resolution of Complaints) Act 1993 should be amended for the following purposes:

- ***to enable the Superannuation Complaints Tribunal to implement an incentive-based system of charging superannuation entities for its resolution of complaints;***
- ***to give the Tribunal discretion to extend beyond one year the time limit for its decision on complaints against trustees' actions on disability payments; and***
- ***to give the Chairperson of the Tribunal discretion to name parties to complaints reviewed by it.*** *(Recommendation 8.3, p. 201)*

Funding of assistance in some 'failure' situations

Part 23 of the Superannuation Industry (Supervision) Act 1993 should be amended to require the Minister to table in Parliament, as soon as practicable, the Australian Prudential Regulation Authority's advice and the reasons for the Minister's decision on whether to provide financial assistance to funds which suffer substantial loss from theft or fraud. *(Recommendation 9.1, p. 211)*

Funding supervision of small self-managed superannuation funds

The Australian Taxation Office should publish the component costs of its regulatory supervision of self-managed superannuation funds to ensure public accountability. *(Recommendation 9.2, p. 215)*

Occupational Superannuation Standards Regulations Application Act

The Occupational Superannuation Standards Regulations Application Act 1992 should be repealed. *(Recommendation 9.3, p. 216)*

Findings

Benefit protection

Protection of small account balances is warranted. (Finding 5.1, p. 85)

Lodgment of annual returns

There is good reason to apply as short a period as feasible for lodgment of superannuation funds' annual returns to APRA. This is consistent with efficient management of these entities and assists APRA to discharge its supervisory responsibilities. A four-month lodgment period appears appropriate. Consideration could be given to allowing a subset of funds to adopt a 31 December reporting date for taxation purposes. Another option would be to allow a subset of funds to adopt a common annual reporting date (to APRA) other than 30 June. (Finding 5.2, p. 98)

A trust focus

The trust basis of the legislation is effective in facilitating prudent management of superannuation entities. Nonetheless, there may be scope to extend the range of prudentially supervised corporations which can provide superannuation products without a trust structure. (Finding 6.1, p. 111)

Trustee representation

The equal representation rules for trustee boards of standard employer-sponsored funds provide balanced representation of employer and employee interests. They are conducive to active member interest in the prudent management of these funds. This benefit exceeds the cost of finding and appointing members who are capable of undertaking trustee duties. (Finding 6.2, p. 113)

Policy committees

Policy committees in master trusts are a relatively low-cost means of facilitating the exchange of views between trustees, members and employers. (Finding 6.3, p. 115)

Application of the Criminal Code and strict liability to offences

The application of the Criminal Code and the strict liability penalty provisions to some offences may deter capable members from volunteering to become trustee representatives of employer-sponsored funds. Accordingly, it would be desirable that APRA issue guidelines to clarify how it intends to exercise its discretion in the application of these provisions. This would reduce the likelihood of members being deterred by uncertainty about the application of the penalty provisions. (Finding 6.4, p. 116–7)

Sole purpose test

The sole purpose test, which restricts the range of services that superannuation funds can provide to their members, is necessary to achieve retirement incomes policy objectives and should be retained. (Finding 6.5, p. 119)

Successor fund transfers

The successor fund provisions are broadly appropriate, although some improvement in the application of the equivalent rights principle could be required. (Finding 6.6, p. 123)

Division of responsibilities

It would be desirable that APRA and ASIC continue to improve coordination of their activities, such as site visits, with a view to reducing the additional costs which have arisen following changes in the administrative arrangements for the SIS Act. (Finding 6.7, p. 138)

Funding supervision of self-managed superannuation funds

Given the more limited nature of their regulatory supervision, it is appropriate that the supervision of self-managed superannuation funds be funded separately from that of other superannuation entities and be based on full recovery of the costs incurred by the ATO in providing that supervision. (Finding 9.1, p. 215)

1 Background to the inquiry

This report fulfils a commitment made in the Commonwealth Legislation Review Schedule to undertake National Competition Policy reviews of the *Superannuation Industry (Supervision) Act 1993* (hereafter referred to as the SIS Act) and five other pieces of superannuation legislation. The focus of the report is on those parts of the legislation that restrict competition and/or impose costs or confer benefits on business (considered for this inquiry to include superannuation entities and those who provide services to them).

1.1 Terms of reference

The terms of reference for the inquiry are stated at the front of this report. In brief, the Commonwealth Government has requested the Commission, within the analytical framework set down in the Competition Principles Agreement of the National Competition Policy, to report on appropriate arrangements for the prudential regulation of superannuation and to fulfil the following requirements:

- identify the nature and magnitude of the social, environmental or other economic problem(s) that the legislation seeks to address;
- clarify the objectives of the legislation;
- identify whether, and to what extent, the legislation restricts competition;
- identify relevant alternatives to the legislation, including non-legislative approaches, and determine a preferred option for regulation, if any;
- analyse and, as far as practicable, quantify the benefits, costs and overall effects of legislation and the alternatives identified;
- identify the different groups likely to be affected by the legislation and alternatives; and
- examine mechanisms for increasing the overall efficiency, including minimising the compliance costs, of the legislation and, where it differs, the preferred option.

These requirements are, in effect, a restatement of the analytical requirements for regulation assessment under the Competition Principles Agreement.

The terms of reference also confine the scope of the review. The Commission is precluded specifically from addressing taxation issues affecting the superannuation industry. Also excluded are aspects of the SIS Act pertaining to self-managed superannuation funds (SMSFs) supervised by the Australian Taxation Office (ATO), rules relating to in-house investments, and matters covered by the *Financial Services Reform Act 2001*.[1] The form and level of cost recovery for regulatory supervision, except in respect of SMSFs, are also beyond the scope of this inquiry. As part of the legislation review process, all of these exclusions have been assessed previously in a National Competition Policy context through the preparation of formal regulation impact statements (ORR 1998).

Given the exclusions, it is apparent that the Commission's inquiry is neither a review of all legislation which affects superannuation nor of retirement incomes policy.

1.2 Legislation under review

The major legislation under review is the SIS Act. Its overarching purpose is to contribute to the Government's retirement incomes policy by providing the regulatory framework for the prudent management of superannuation entities and for their supervision by the Australian Prudential Regulation Authority (APRA), Australian Securities and Investments Commission (ASIC) and the ATO.

The SIS Act sets out requirements which must be met by those who manage, or supply certain services to, superannuation entities. It also prescribes an extensive range of operating standards and places a number of obligations on trustees which must be complied with in order for the entity to be eligible for concessional tax treatment. Major elements of the Act include:

- definitions of the basic duties and responsibilities of trustees;
- requirements for disclosure to members and regulatory authorities;
- roles for auditors and actuaries in ensuring compliance by superannuation entities with SIS provisions; and
- enforcement powers for the regulatory agency.

An overview of the SIS Act is provided in chapter 3.

1 The Financial Services Reform Act will become operational in March 2002. It will apply to the financial sector generally and incorporate product disclosure standards and the licensing of financial service providers. Accordingly, the Act includes provisions covering aspects of superannuation product disclosure and consumer protection presently contained in the SIS Act.

The other legislation under review complements the SIS Act. These Acts are as follows:

- *Superannuation (Resolution of Complaints) Act 1993,* which provides for the establishment and operation of the Superannuation Complaints Tribunal to review member complaints unable to be resolved by their fund trustees;
- *Superannuation (Financial Assistance Funding) Levy Act 1993,* which provides for the imposition of a levy on superannuation funds and approved deposit funds to assist funds that have suffered losses as a result of fraudulent conduct and theft;
- *Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition Act 1991* and the *Superannuation (Self Managed Superannuation Funds) Taxation Act 1987*, which provide for the determination of a levy, and the administrative provisions for that levy, respectively, on SMSFs to pay for ATO supervision of their compliance with the SIS Act; and
- *Occupational Superannuation Standards Regulations Application Act 1992,* which was introduced to overcome some uncertainty about the validity of certain regulations relating to the superannuation guarantee scheme made under the *Occupational Superannuation Standard Act 1987,* the forerunner to the SIS Act.

These Acts are reviewed in chapters 8 and 9.

1.3 Analytical framework

An important element of National Competition Policy is the Competition Principles Agreement, which contains, inter alia, principles for dealing with the review and, where appropriate, reform of legislation which restricts competition. The guiding principle is that legislation should not restrict competition unless it can be demonstrated that the benefits of the restriction outweigh the costs, and the objectives can only be achieved by restricting competition (box 1.1).

While restrictions on competition may be necessary to achieve certain economic and social objectives, they can also impose substantial costs through higher prices, reduced choice and impediments to innovation and efficiency. Reflecting these potential costs, the core principle for National Competition Policy reviews effectively means that legislative restrictions are to be removed unless they can be shown to confer a net benefit on the Australian community and unless restricting competition is the only way to achieve the objectives of the legislation. Alternative approaches which may not restrict competition include quasi-regulation and self-regulation.

Box 1.1 Legislation review principles set out in the Competition Principles Agreement of National Competition Policy

The Australian governments have agreed to apply the following principles to their reviews of legislation:

5.(1) The guiding principle is that legislation (including Acts, enactments, Ordinances or regulation) should not restrict competition unless it can be demonstrated that:

(a) the benefits of the restriction to the community as a whole outweigh the costs; and

(b) the objective of the legislation can only be achieved by restricting competition.

…

5.(9) Without limiting the terms of reference of a review, a review should:

(a) clarify the objectives of the legislation;

(b) identify the nature of the restriction on competition;

(c) analyse the likely effect of the restriction on competition and on the economy generally;

(d) assess and balance the costs and benefits of the restriction; and

(e) consider alternative means for achieving the same result including non-legislative approaches.

Source: Competition Policy Reform Act 1995, Competition Principles Agreement.

In analysing restrictions on competition, the body formed to oversee the implementation of National Competition Policy — the National Competition Council — has issued a generic list of regulation types which may directly or indirectly restrict competition. Components of this list with potential relevance to the superannuation legislation under review are reproduced in box 1.2.

In addition to the Competition Principles Agreement framework, the Commission is required to have regard to the analytical requirements for regulation assessment by the Commonwealth (box 1.3).

In addition to the need to assess restrictions on competition arising from the legislation, the terms of reference direct the Commission to focus on those parts of the legislation which impose costs or confer benefits on business. Any assessment of such benefits and costs for legislation review purposes requires a comparison between the legislation and what would (hypothetically) exist in its absence.

The terms of reference ask the Commission to identify the different groups likely to be affected by the legislation. Members of superannuation entities are the

Box 1.2 Types of regulations which may restrict competition

The National Competition Council identified legislation affecting competition as legislation which may directly or indirectly:

- govern the entry and exit of firms or individuals into or out of markets;
- control prices or production levels;
- restrict the quality, level of goods and services available;
- restrict advertising and promotional activities;
- restricts price or type of inputs used in the production process;
- be likely to confer significant costs on businesses;
- provide advantages to some firms over others by, for example, sheltering some activities from the pressures of competition; or
- determined pricing arrangements for nominated goods and services.

Source: NCC (1997).

Box 1.3 Analytical requirements for Commonwealth regulation impact statements

The analytical requirements for regulation impact statements are based around an impact analysis of feasible options. The requirements involve the consideration of seven items:

1. Who is affected by the problem and who is likely to be affected by its proposed solution?
2. How will each proposed option affect existing regulations and the roles of existing regulatory authorities?
3. Identify and categorise the expected impacts of the proposed options as likely benefits and costs.
4. Determine which groups are likely to experience these benefits and costs and what the extent of their likely impacts are likely to be. Quantify these effects where possible.
5. Identify distributional effects and attribute these to the groups affected.
6. Identify the data sources and assumptions used in making these assessments.
7. Summarise outcomes for each option examined.

Source: ORR (1998).

principal beneficiaries of the current legislation, which requires prudent management of their superannuation contributions and entitlements. Other groups affected by the legislation include:

- trustees;
- employers who make superannuation contributions on behalf of employees and businesses which have their own corporate fund;
- financial institutions which provide both superannuation and non-superannuation products to the public;
- service providers (such as investment managers, custodians, administrators, asset consultants, auditors, accountants, and lawyers); and
- taxpayers, through the impacts on public finance of tax concessions and age pensions.

The benefits for some groups of the SIS Act and other legislation under review often come wholly or partly at a cost to others. An economy-wide perspective of the legislation involves accounting for all impacts on all groups, in order to assess the net effect of the legislation on the community. In reviewing individual provisions of the SIS legislation, the Commission has initially identified their contribution to the overall objectives of the legislation that requires there to be restrictions on competition. The provisions are then evaluated in terms of the compliance costs they impose in meeting those objectives. Where a provision could meet its objective with less restriction on competition or in a more cost-effective way, an alternative to the existing arrangements has been recommended.

1.4 Participants' views

In submissions received from, and discussions held with, participants, a number of common themes emerged regarding the current regulatory framework governing superannuation in Australia. Participants were generally supportive of the broad aims of prudential regulation of superannuation entities and the requirements placed on trustees. Many, however, also expressed concern about the complex and prescriptive nature of the SIS Act. The need for a legislative basis for independent prudential regulation was unquestioned.

On the whole, participants considered that the existing arrangements allow a satisfactory level of competition. Nonetheless, some pointed to particular provisions of the SIS Act which they considered either as limiting competition, or adding significantly to compliance costs. Participants' comments largely focussed on the provisions of the SIS Act and the Resolution of Complaints Act; their comments were largely supportive. There was very little mention of the other Acts under review.

1.5 Conduct of the inquiry

The Commission released an Issues Paper in March 2001 inviting written submissions on matters raised by the terms of reference. In response, 49 submissions were received from a range of groups including: superannuation fund associations; trustees; individual and representative service providers such as fund administrators, accountants and actuaries; regulatory authorities; state governments and a number of individuals.

To gain a better understanding of the impacts of the legislation on the superannuation industry, the Commission undertook an extensive round of visits in Sydney, Melbourne and Canberra. The Commission held discussions with 38 interested parties with broad representation across the groups mentioned above. In addition, an initial round of public hearings was conducted in May 2001, at which 16 groups and individuals presented evidence.

The Commission released its draft report, incorporating the views expressed by participants in submissions and discussions, in September 2001. A further 25 submissions were received following its release. Public hearings were also held on the draft report in October 2001. At those hearings, 12 groups and individuals presented evidence.

Those who made submissions, and the groups and locations which the Commission visited to hold informal discussions, are listed in appendix A.

1.6 Report structure

The next chapter looks at developments in superannuation policy and regulation and the superannuation industry over the last 20 years. An overview of the SIS Act is provided in chapter 3.

Chapters 4 and 5 form the main basis of the Commission’s review of the SIS Act. Chapter 4 analyses the impact of the existing legislation on competition within the superannuation industry, while chapter 5 examines areas of the legislation which impose significant compliance costs on the industry.

Chapter 6 examines areas of the SIS legislation, other than those reviewed in chapters 4 and 5, which are either fundamental to the achievement of the legislation's objectives or the subject of some concerns by participants about their effects on competition and compliance costs.

Alternative means of achieving the objectives of key provisions of the SIS legislation are the focus of chapter 7. The final two chapters review the other Acts under reference.

2 The superannuation industry

This chapter looks at the evolution of the superannuation industry over the last 20 years. In that time, assets under management in superannuation funds have grown from $32 billion to $527 billion and now comprise 15 per cent of total private sector wealth. This growth has reflected the spread of superannuation throughout the workforce, higher contribution rates and superannuation fund earnings. The structure of the industry has been undergoing considerable change. The most notable trend over recent years is industry consolidation, driven by specialisation and economies of scale. The outcome has been a steady reduction in the number of funds (other than small self-managed superannuation funds) and a corresponding increase in average fund size. Fund administration costs have been declining for several years. In part, this trend reflects the impact of competition.

This chapter looks first at the impact of the regulatory environment on the superannuation industry over the last twenty years. The major influences on the evolution of superannuation assets over this period is then reviewed. Factors affecting future growth, including the increasing importance of superannuation assets in individual wealth, are also discussed. The next two sections analyse changes in the financial and industrial structure of the industry since the mid-1990s — the period after the introduction of the SIS Act. The final section provides an analysis of fund administration costs — the main area where compliance with the SIS Act has its impact.

2.1 Regulatory environment

Although the regulatory environment governing superannuation has evolved in response to changing circumstances, the consistent objective underlying this regulation has been to increase superannuation saving and protect fund members' superannuation entitlements. This reflects the role that superannuation plays in retirement incomes policy, the compulsory nature of some superannuation and its long-term character. Standards relating to the prudent management of funds are a key element of the regulatory environment. In addition, the prevention of inappropriate use of the tax concessions afforded to superannuation is an important policy objective.

Access to superannuation has been available in Australia since the mid-nineteenth century. Its role in retirement incomes policy, and the evolution of the regulatory environment which governs it have, however, been relatively recent phenomena. The last two decades, in particular, have witnessed significant changes in both superannuation policy and regulatory structures. The most important changes have been the introduction of: mandatory superannuation contributions through industrial awards and the Superannuation Guarantee (SG); taxation measures to increase voluntary contributions, improve equity and avoid abuse of concessions; a prudent management framework for the trustees of superannuation funds; and a new institutional framework for prudential supervision.

One of the earliest policy initiatives involved reforms to taxation arrangements in 1983. These changes were designed to remove the bias against taking benefits as an income stream rather than a lump sum and to address concerns that high income individuals with access to superannuation were benefiting from concessional tax treatment not available to the wider community.

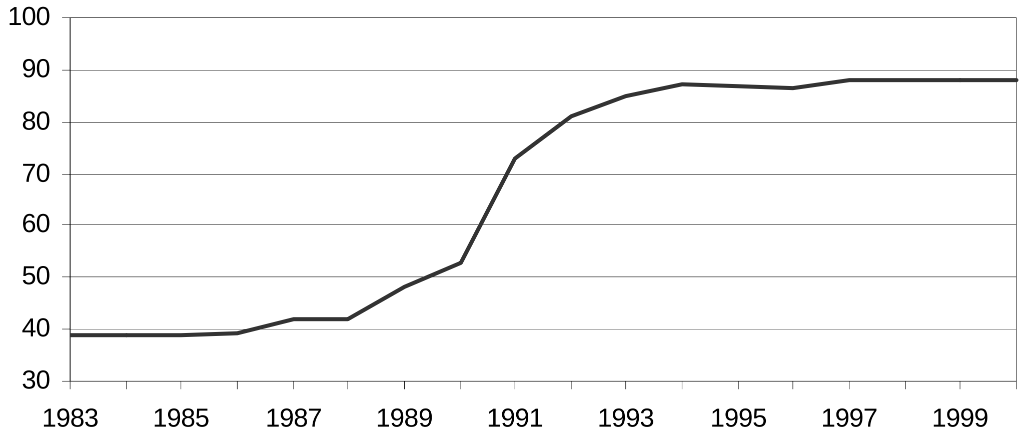
At the time of these changes, around 40 per cent of employees were covered by superannuation. In part reflecting the view that taxation incentives alone would not achieve widespread superannuation coverage, the next major development occurred in 1986 with the endorsement by the Australian Conciliation and Arbitration Commission of a 3 per cent employer superannuation contribution as part of a national wage claim. Although there were early implementation problems, this marked an important turning point in superannuation coverage.

Following the introduction of award superannuation, the prudential framework covering superannuation was modified and guidelines were issued on standards relating to the trusteeship of superannuation funds. A new regulatory regime, the Occupational Superannuation Standards Act was introduced in 1987. It set out the operational standards that superannuation funds would need to comply with in order to be eligible for concessional taxation treatment. The Insurance and Superannuation Commission was established to oversee the implementation and administration of the Act.

Superannuation coverage spread gradually following the 1986 national wage case decision and, by 1990, had reached around 50 per cent of employees. This meant that the cost to government revenue from superannuation tax concessions was also increasing and, as a result, new taxation measures were introduced to bring forward superannuation taxation liabilities.

Reflecting the view that superannuation coverage had not spread far enough, another milestone in superannuation policy was the introduction of the SG. Under the SG, from 1 July 1992, all employers (including those not operating under awards) were effectively required to contribute 3 per cent of earnings to a regulated superannuation fund. A timetable was also introduced under which the contribution rate would gradually increase to 9 per cent of earnings in July 2002. Under that legislation, superannuation coverage has spread to almost 90 per cent of employees (figure 2.1).

Figure 2.1 **Superannuation coverage, 1983 to 2000**
(per cent of employees)



Sources: APRA (*Insurance and Superannuation Bulletin*, various issues); APRA (2001k); Treasury (2001c).

The introduction of the SG was accompanied by further reform of the prudential framework governing superannuation funds and a tightening of the preservation rules restricting access to superannuation benefits. A major element of this reform process was the introduction of the SIS Act. The SIS Act replaced the Occupational Superannuation Standards Act on 1 July 1994 as the basis for government regulation and supervision of the superannuation industry. It remains the dominant piece of legislation setting prudential standards and protecting superannuation fund members. The SIS Act is the principal focus of this report. An overview of the Act and its provisions is presented in chapter 3.

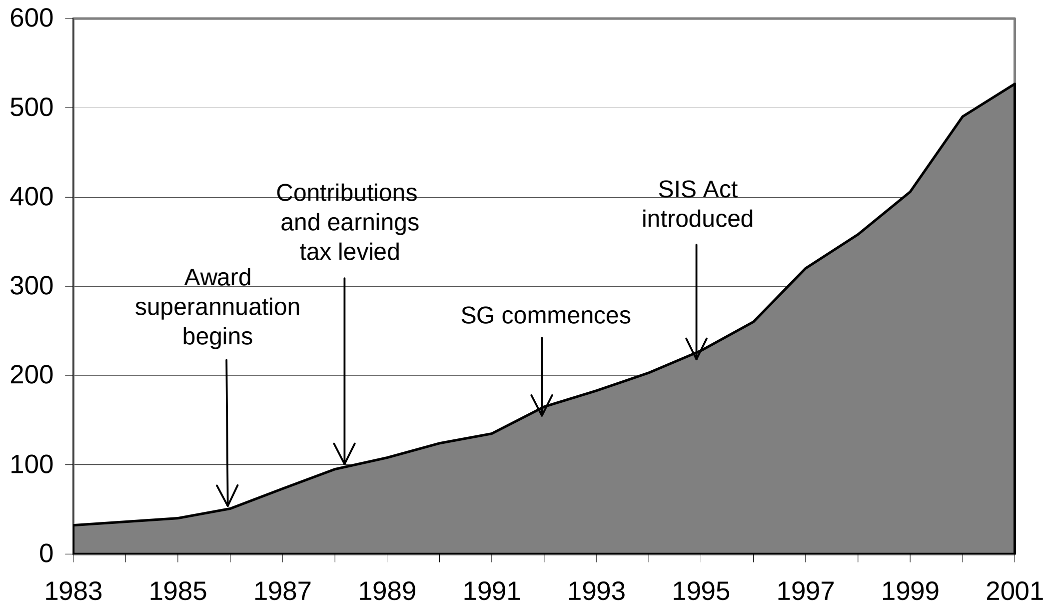
As a result of the recent inquiry into the Australian financial system, a comprehensive overhaul of the regulatory framework governing the entire financial sector has been put in train. One outcome was the creation, in 1998, of APRA which assumed the role of administering the prudential elements of the SIS Act previously the responsibility of the Insurance and Superannuation Commission.

Another involved moving responsibility for consumer protection issues under the SIS Act to the newly formed ASIC (FSI 1997). A further development was an amendment to the SIS Act in 1999, as a result of which small self-managed superannuation funds (SMSFs), with fewer than five members, became regulated by the ATO. The institutional framework covering superannuation will also be affected by the passing of the *Financial Services Reform Act 2001* which will become operational on 11 March 2002. The Act deals with disclosure and consumer protection issues for the entire financial services industry. Matters dealt with by the Act are outside the terms of reference of this review.

2.2 Superannuation asset growth and development

Superannuation assets have grown substantially over the past two decades (figure 2.2). The value of the stock of assets at the end of the June quarter 2001, at $527 billion, represents a compound annual growth rate of just over 17 per cent from the $32 billion in assets at the end of the June quarter 1983.[1]

Figure 2.2 **Superannuation assets, June 1983 to June 2001**
($ billion)



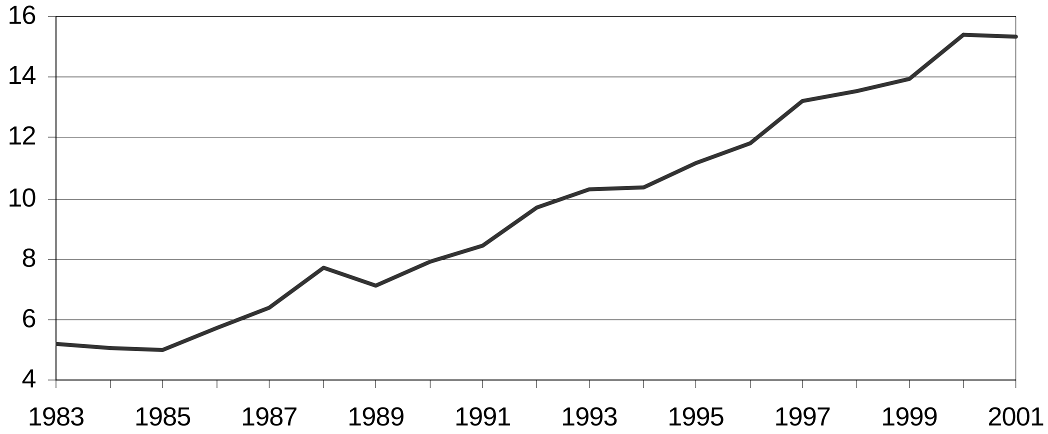
Source: APRA (2001k).

In comparison, the value of total private wealth has grown at a compound rate of around 10 per cent per year over the same period. As shown in the figure, the introduction of award superannuation in 1986 was associated with a marked growth in the stock of superannuation assets which has continued following the introduction of the SG in 1992.

1 As inflation over the 1990s has been more subdued than in the preceding decade, the increase in superannuation assets in real terms has been even greater than in the 1980s.

The faster growth in superannuation assets than in total private wealth has had a marked impact on the share of superannuation in total private wealth over the last twenty years (figure 2.3). Based on the Commonwealth Treasury's private sector wealth estimates, the share of superannuation in total private wealth has increased from 5 per cent in 1983 to around 15 per cent in 2001.[2]

Figure 2.3 **Superannuation as a share of total private wealth, 1983 to 2001**
(per cent)



Sources: APRA (2001k) and Treasury (2001b).

Sources of growth

In addition to the policy-induced spread of superannuation throughout the workforce, the growth in superannuation assets has been associated with higher contribution rates and fund earnings.

Superannuation contributions

The higher contribution rates under the SG and increased levels of member contributions have been a major source of growth in recent years. Available data show that, between the end of the June quarter 1995 and the end of the June quarter 2001, total superannuation assets increased by $300 billion. During the same period, net superannuation contributions (that is, gross contributions less benefit payments

2 The Treasury estimates do not include unfunded superannuation claims on governments. Inclusion of these claims would raise the share of superannuation in private sector wealth. See Treasury (2001b) for a description of the methodology used to construct the wealth series.

plus net transfers into superannuation funds) accounted for around 48 per cent ($143.8 billion) of the total increase.

A notable trend over this period has been the stronger growth in member contributions (made by employees and others) compared to contributions made by employers. In 1995-96, gross member contribution flows amounted to 31 per cent of total gross contribution flows. In 2000-01, such contributions had risen to 45 per cent of total contributions (table 2.1).

Table 2.1 **Gross superannuation contribution flows, 1995-96 to 2000-01[a]**

Year	*Employer*		*Member*		*Total*	
	$ million	*% of total*	*$ million*	*% of total*	*$ million*	*% of total*
1995-96	18 113	69	8 225	31	26 338	100
1996-97	19 122	66	9 976	34	29 098	100
1997-98	21 643	61	13 766	39	35 409	100
1998-99[b]	21 978	55	17 759	45	39 737	100
1999-00	25 961	56	20 362	44	46 323	100
2000-01	27 683	55	22 989	45	50 672	100

a Totals do not include balance of statutory funds. **b** During 1998-99, $8.4 billion in exceptional employer contributions were made by three public sector funds. This amount has not been included in the table.

Sources: APRA (2001j,k).

The growth in member contributions by employees and other non-employers reflects a number of factors including increased participation by self-employed persons in superannuation, higher levels of eligible spouse contributions and 'contribution recycling' (where a lump sum payment is taken and immediately reinvested in a pension or annuity).

Fund earnings

Another key source of growth in total superannuation assets has been fund earnings, which comprise net investment income (for example, interest, dividends and rents) and asset price changes. As noted above, total superannuation assets increased by $300 billion between the end of the June quarter 1995 and the end of the June quarter 2001. Over the same period, net investment income on fund assets and asset price changes accounted for $157.8 billion or 53 per cent of the total increase.[3] Based on assets held at the beginning of each quarter, this represents an average annual return of almost 9 per cent per annum over this six year period.[4]

3 According to APRA (2001i), the change in total assets is made up of net contributions plus net investment income less operating expenses plus other changes.

4 This figure does not include investment income earned on annuities and life office reserves.

As discussed later, the bulk of superannuation assets are held in domestic equities and unit trusts. Domestic equity prices have appreciated considerably since the end of the June quarter 1995 and have been the major contributor to the earnings performance of superannuation funds. Between the end of the June quarter 1995 and the end of the June quarter 2001, domestic equity prices (as measured by movements in the ASX 200 index) rose by around 73 per cent (a compound growth rate of almost 10 per cent per annum). Importantly, as superannuation benefits are preserved until retirement, this means that, at this stage, the bulk of earnings are reinvested, effectively compounding investment returns.

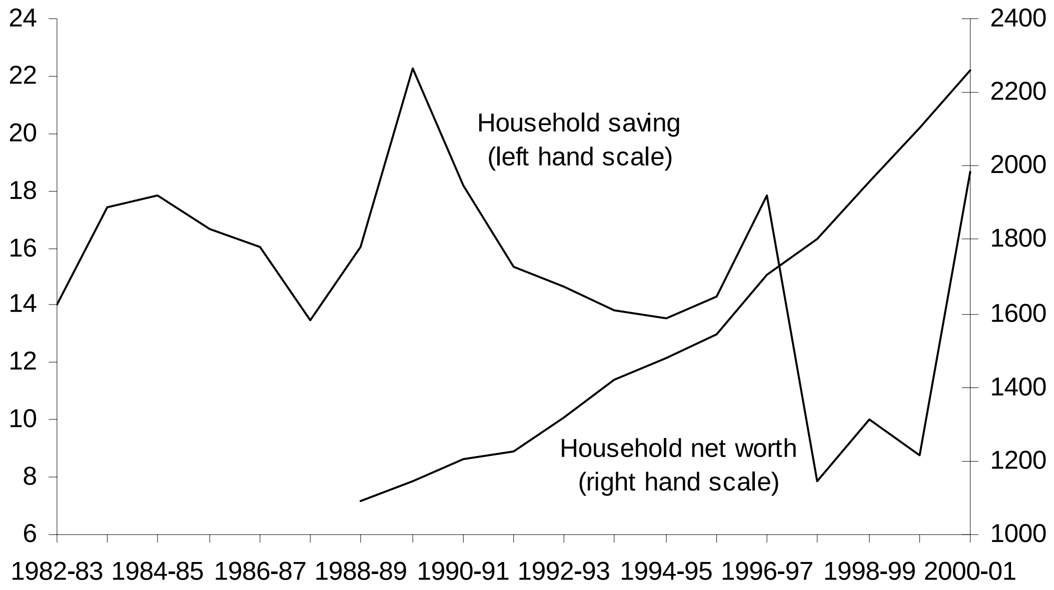
Superannuation as a component of household saving

Although superannuation contributions have grown rapidly over the last twenty years, the aggregate nominal level of household saving is no higher now than it was in 1983-84 — although it has varied during this period (figure 2.4). This implies that the increase in superannuation contributions has occurred, in large part, at the expense of more traditional savings instruments (and has been accompanied by rising household debt). A relatively recent Australian study which looked at the relationship between superannuation and other forms of household saving found that, between 1960 and 1995, about three-quarters of the variation in superannuation saving was offset by changes in other forms of saving (Morling and Subbaraman, 1995). The authors noted that these results were consistent with those of overseas studies which found large offsets between saving through retirement income plans and other forms of saving.

One implication of this is that if superannuation is simply serving as a substitute for other forms of long-term saving, the net amount available for other household investment purposes may be lower than would otherwise be the case. The impact of superannuation saving on the total level of household saving is unclear. On the other hand, the net worth of households (as measured by the excess of their assets over their liabilities) has increased (figure 2.4). Rising asset prices, particularly during the 1990s, have contributed significantly to this increase.

Projections of growth in superannuation assets prepared by the Commonwealth Treasury's Retirement Income Modelling Taskforce envisage total assets growing fourfold to reach $1700 billion by 2020 in current price terms (table 2.2). Factors contributing to this projected growth include the increase in the SG to 9 per cent of earnings in 2002-03; policies aimed at increasing the coverage rate for the self-employed (for example, rollover facilities for the sale of small businesses); the gradual increase in the preservation age from 55 to 60 and measures such as tax rebates for contributions on behalf of non-working spouses.

Figure 2.4 **Household saving and net worth, 1982-83 to 2000-01[a]**
($ billion, current prices)



[a] Household saving includes employer and employee contributions to superannuation funds.

Sources: ABS (2001a, b).

Table 2.2 **Superannuation assets by fund type, 2000 to 2020**
($ billion, current prices)

Year	*Public sector defined benefit*	*Private sector defined benefit*	*Private sector defined contribution*	*SG contribution*	*Self-employed*	*Personal and rollover funds*	*Total[a]*	*Total as per cent of GDP*
2000	90	79	50	56	33	63	426	69
2005	123	111	77	109	40	92	643	82
2010	163	153	115	181	47	120	931	96
2015	206	203	163	272	53	150	1 280	107
2020	254	262	222	381	60	181	1 699	117

[a] Figures do not add across to total as some funds within the superannuation system, such as rollover funds, annuities and allocated pensions held on behalf of the retired, have not been explicitly listed.

Source: Tinnion and Rothman (1999).

All superannuation categories represented in the table are expected to contribute to the overall increase in superannuation assets. The strongest growth comes from SG contributions, which are projected to rise seven-fold to $381 billion between 2000 and 2020. Private sector defined contribution (or accumulation) funds are projected to grow five-fold and private and public sector defined benefit funds by 330 per cent and 280 per cent, respectively. Personal superannuation and rollover funds (including assets for the self-employed) are projected to grow by 290 per cent.

On the basis of the Retirement Income Modelling Taskforce projections of growth in superannuation assets, and assuming that the total number of member accounts grows in line with the general population, average account balances would increase to around $60 000 by 2020. If the present number of accounts per member is maintained at three, this suggests that superannuation holdings will average $180 000 per member by 2020.

The increasing importance of superannuation, and its compulsory nature, underline the need for the prudent management of members' entitlements. It also highlights the need for an effective regulator and complaints resolution mechanism.

2.3 Financial structure of the industry

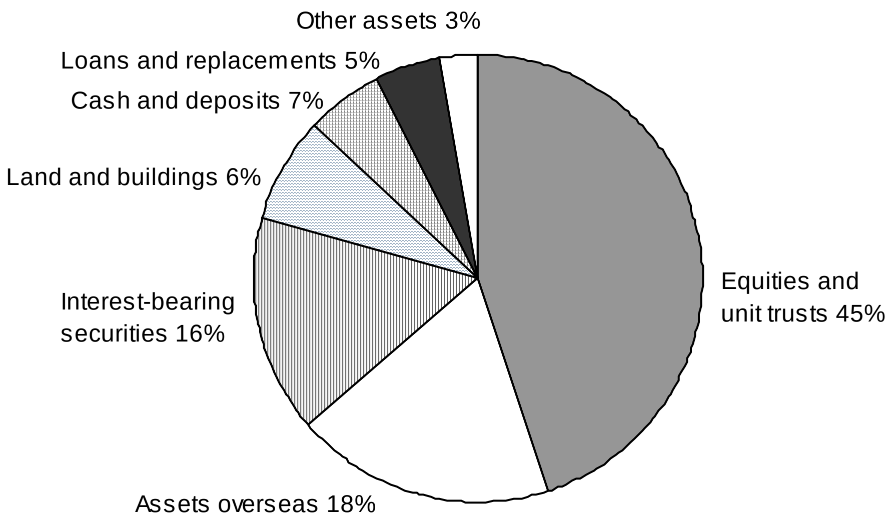
Asset allocation

Reflecting the long-term nature of superannuation savings, asset allocation is dominated by investments that typically provide higher returns over longer time horizons. Investments in domestic equities, for example, have proved to be relatively high yielding investments over time and accounted for 45 per cent of total superannuation assets at the end of the June quarter 2001 (figure 2.5). Overseas assets (which include equities, bonds and other asset types) accounted for a further 18 per cent of total superannuation assets.[5]

The relatively high share of total superannuation assets currently invested domestically is somewhat surprising given the relatively small size of the Australian asset market and the benefits of portfolio diversification. The Australian equity market accounts for less than 2 per cent of the global equity market. The proportion of superannuation assets invested overseas is, however, rising. It grew from just under 15 per cent of total superannuation assets at the end of the June quarter 1995 to over 18 per cent at the end of the June quarter 2001.

5 Most of the disaggregated data presented in this section are from the APRA Quarterly Survey of Superannuation — a joint APRA and ABS survey introduced in 1995 (a little over a year after the SIS legislation came into force). Information collected in the survey covers more than 90 per cent of total superannuation assets, members, contributions and benefits. This information is supplemented by APRA estimates of funds outside the survey. For more on the survey methodology see APRA (1999b). Some industry participants have been critical of the accuracy of the statistics derived from the survey — see, for example, ASFA (sub. 34).

Figure 2.5 **Asset allocation, June 2001**



Source: APRA (2001k).

Since the end of the June quarter 1995, just over half of the increase in total superannuation assets has been accounted for by growth in Australian equity investments. Growth in overseas assets has contributed around 20 per cent of the total increase.

Superannuation benefits

The benefit structures of superannuation funds take two basic forms. Defined contribution (or accumulation) funds provide members with a lump sum of accumulated contributions and earnings once the member retires from the workforce and has reached preservation age. Defined benefit funds, on the other hand, pay benefits (as lumps sums and/or income streams) according to pre-determined criteria which may not be based on members' contributions and earnings. An example would involve the payment of an income stream which is determined by a member's length of contributory service and the final salary earned just prior to retirement from the workforce and on reaching preservation age.

There has been a marked shift away from defined benefit fund structures and toward accumulation fund structures over the last two decades (table 2.3). In 1982-83, more than 80 per cent of superannuation fund members were in defined benefit funds. By 1999-2000, this had fallen to around 14 per cent.

Table 2.3 **Proportion of members in defined benefit and accumulation funds, 1982-83 to 1999-2000**

(per cent)

Year	*Defined benefit fund members*	*Accumulation fund members*
1982-83	82	18
1991-92	27	73
1999-00	14	86

Source: Treasury (2001c).

The main reason for this dramatic change was that most industry funds established to accept award superannuation contributions, and subsequently SG payments, were accumulation funds. In addition, the greater complexity of administering defined benefit funds and the risk faced by the employer in providing the eventual defined benefit have led to a shift away from the provision of defined benefit funds by corporate employers. This trend has also had implications for the nature and importance of services provided to the superannuation industry — particularly the role of actuaries.

At the end of the June quarter 2001, superannuation funds providing accumulation benefits accounted for 64 per cent ($310 billion) of total superannuation assets. Retail and industry funds are more likely to offer this benefit structure. Funds providing only defined benefits accounted for 5 per cent ($25 billion) of total superannuation assets. Corporate and public sector funds are more likely to offer this benefit structure. The remainder, some 31 per cent or $153 billion in assets, was accounted for by hybrid funds.[6]

The current dominance of accumulation funds means that the most common type of benefit payment is a lump sum. During the June quarter 2001, 79 per cent of the $7.9 billion of total benefits paid to superannuation fund members was in the form of lump sums. However, a portion of these lump sum payments re-enter the superannuation system through the purchase of concessionally-taxed income streams.

6 The total used to calculate share of assets by benefit structure does not include $39 billion in annuities and life office reserves.

2.4 Industry composition

Superannuation funds

Most contributions are made to superannuation funds overseen by trustees which are required to comply with the provisions of the SIS Act in order to obtain concessional taxation treatment. These funds also provide lump sum and retirement income payments to their members.

At the end of the June quarter 2001, there were around 226 000 complying superannuation funds in Australia managing $527 billion in assets on behalf of 23.2 million member accounts (table 2.5). Small funds that contain fewer than five members account for 98 per cent (approximately 223 000) of all superannuation funds. In November 1999, the ATO assumed responsibility for SMSFs, of which there were nearly 215 000 at the end of the June quarter 2001. The terms of reference for this inquiry exclude consideration of the impact of the SIS legislation on this large group of funds.

The remaining 11 794 funds are supervised by APRA. Approximately three-quarters of these funds must have trustees approved by APRA (see chapter 4). Most of them are so-called small APRA funds with fewer than five members. The remaining one-quarter of the funds supervised by APRA are employer-sponsored funds which operate without approved trustees. They are governed by boards comprised of equal members of employer and employee representatives.

More than half of the assets held by APRA-supervised funds at the end of the June quarter 2001 were held by funds with approved trustees — largely retail funds. These funds had three-quarters of all superannuation accounts. Virtually all member accounts and assets invested by employer-sponsored funds were held by funds with assets greater than $10 million at the end of the June quarter 2001. These funds had an average size of $175 million (table 2.4).

Apart from the small APRA funds, APRA-supervised funds comprise four categories:[7]

- *Corporate funds* are sponsored by a single employer or group of related employers and cover their employees.

7 These categories are not derived from the regulations. The SIS Act has its own definitions of superannuation entities.

Table 2.4 **Funds regulated by APRA, June 2001**

Type of fund	*Funds*	*Member accounts*		*Assets*		*Average fund size*
	No.	'000	%	$ billion	%	$ million
Funds with approved trustee	**8 498**	**14 920**	**75.7**	**164.0**	**54.7**	**19.3**
Public offer	391	12 120	61.5	156.8	52.2	400.9
Small APRA funds[a]	7 699	10	0.1	2.3	0.8	0.3
Other regulated funds	408	2 790	14.1	5.0	1.7	12.3
Funds without approved trustee: employer-sponsored funds	**2 862**	**4 791**	**24.3**	**136.2**	**45.3**	**47.6**
< $1 million	1 071	19	0.1	0.4	0.1	0.4
$1 million – $5 million	789	54	0.3	1.9	0.6	2.4
$5 million – $10 million	250	47	0.2	1.8	0.6	7.2
> $10 million	743	4 671	23.7	132.0	44.0	175.3
Total	**11 360**	**19 711**	**100.0**	**300.2**	**100.0**	**26.4**

[a] The figure for small APRA funds in this table relates to current funds (that is, those small funds which had submitted an APRA annual return in 1999 or 2000).

Source: Hockey (2001a).

- *Industry funds*, often organised through industrial workplace arrangements, cater for members as a result of an agreement between the parties to an industrial award. An individual industry fund typically draws members from a large number of usually unrelated employers, often across a single industry. Some industry funds are now offering their products to the public at large, like retail funds.
- *Retail funds* are public offer superannuation funds that members join by purchasing investment units or policies that are sold through intermediaries such as financial planners. Members of retail funds may include self-employed people or people wishing to 'top-up' their employment-based superannuation arrangements. Employers may use retail superannuation products to meet their superannuation obligations in respect of their employees — for example, by using a retail master trust.
- *Public sector funds* are those where the sponsoring agency (at Commonwealth, State or Territory level) or government business enterprise is majority government owned.

The nature and development of these fund categories influence the level and character of competition for superannuation contributions. Employers in certain industries, for example, are likely to channel contributions for their employees, whether as part of the SG or through workplace agreements, exclusively into affiliated industry funds. Most public sector employees have employer contributions paid into public sector funds.

In contrast, retail and industry funds offer a broader range of superannuation products (such as annuities and allocated pensions) and contribution acceptance arrangements (such as those on behalf of a spouse or for self-employed persons) which provide greater scope for voluntary contributions to be made by members of the public. As a result, retail funds mainly compete with industry funds, for the bulk of voluntary superannuation contributions.[8]

At the end of the June quarter 2001, retail funds held the largest share of superannuation assets, with 30 per cent of the total or $160 billion. Public sector funds held 22 per cent of total assets ($114 billion); small funds, 17 per cent ($87 billion); corporate funds, 15 per cent ($81 billion); industry funds, 9 per cent ($45 billion); and annuities, 7 per cent ($39 billion). Small fund asset holdings were dominated by SMSFs with 16 per cent of the total ($85 billion); small APRA funds held only $2 billion (table 2.5).

At the end of the June quarter 2001, account balances averaged around $23 000. In part reflecting difficulties in arranging portability between funds, there was an average of three accounts per member. This equates to an average balance per member of $69 000 — 82 per cent higher than the $38 000 average balance per member at the end of the September quarter 1995 (the earliest available data).

Industry structure has been undergoing considerable change. Over recent years, industry consolidation (driven mainly by specialisation and economies of scale) has resulted in a steady reduction in the number of funds and a corresponding increase in average fund size (tables 2.6 and 2.7).[9]

A notable feature has been the substantial decline in the number of corporate funds (the category with the lowest average fund size). Almost 1000 (or about 23 per cent) of these funds closed between 1995 and 2001. This has been mainly due to a move by medium-sized and smaller corporate funds toward master trust arrangements. Possible reasons for this trend include the perceived complexity of superannuation and taxation legislation and a lack of sufficient economies of scale to support cost

8 According to APRA (*Insurance and Superannuation Bulletin*, June 1999), 59 per cent of all voluntary contributions were received by retail funds in 1997-98.

9 APRA points out that the functional descriptions shown in the tables are chosen by the funds themselves and that this may distort aggregate statistics when determining the number of funds in each category. Given the problems in accurately determining fund type, APRA conducted a review (APRA 2001g) which led to the reclassification of funds into appropriate categories. Another problem relates to the classification of funds which do not lodge returns by the due date.

effective in-house provision of superannuation coverage for members. Companies might also have decided to focus on their core business activities, leaving management of their superannuation schemes to others. Similarly, retail fund numbers have declined by almost half (from a much smaller base) reflecting, again, efforts to take advantage of scale economies by way of larger average fund sizes, including through mergers.

Table 2.5 **The superannuation industry, June 2001**

Type of fund	*Funds*	*Member accounts*		*Assets*	
	No.	'000	% of total	$ billion	% of total
Corporate or enterprise	3 235	1 570	7	81	15
Industry	139	6 977	30	45	9
Public sector	94	2 846	12	114	22
Retail	274	11 459	49	160	30
Subtotal	***3 742***	***22 852***	***98***	***400***	***76***
SMSFs	214 686	377	2	85	16
Small APRA funds[a]	8 052	10	-	2	-
Subtotal	***222 738***	***387***	***2***	***87***	***17***
Annuities, life office reserves, etc	na	na	na	39	7
Total	**226 480**	**23 238**	**100**	**527**	**100**

[a] The figure for small APRA funds in this table relates to both current funds (that is, those small funds who had submitted an APRA annual return in 1999 or 2000) and non-current funds (that is, those small funds who did not submit an APRA annual return in 1999 or 2000 and have not communicated their status as an SMSF).

Source: APRA (2001k).

Table 2.6 **Number of superannuation funds, June 1995 to June 2001**

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*
Corporate	4 211	4 110	4 118	3 910	3 597	3400	3235
Industry	152	160	164	161	146	144	139
Public sector	97	92	91	89	95	94	94
Retail	541	385	351	326	307	292	274
Subtotal	***5001***	***4747***	***4724***	***4486***	***4145***	***3930***	***3742***
Small funds[a]	100 447	126 349	147 971	173 116	193 396	210 366	222 738
Total	**105 448**	**131 096**	**152 965**	**177 602**	**197 541**	**214 296**	**226 480**

[a] Small funds include SMSFs and small APRA funds.

Source: APRA (2001k).

Table 2.7 **Average fund size, June 1995 to June 2001**
($ million)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*
Corporate	12	14	15	17	19	23	25
Industry	67	95	121	151	204	258	326
Public sector	532	638	780	896	1 003	1 179	1 216
Retail	96	161	222	279	366	472	585
Small funds[a]	0.2	0.2	0.2	0.2	0.3	0.4	0.4

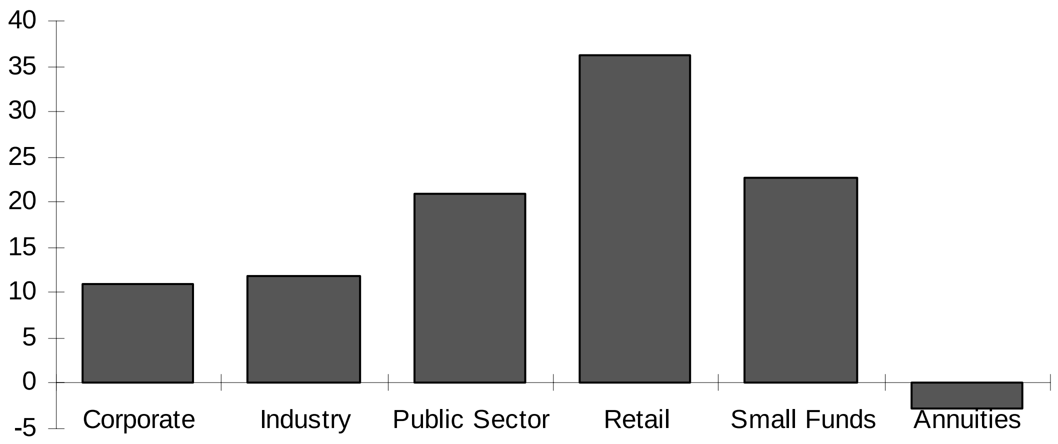
a Small funds include SMSFs and small APRA funds.

Source: Derived from APRA (2001k).

Assets managed through retirement savings accounts (a superannuation product introduced in September 1998) reached just over $3 billion at the end of the June quarter 2001. While the rate of growth in retirement savings accounts since their introduction has been substantial, they currently represent less than 1 per cent of total superannuation assets.

Since the end of the June quarter 1995 (when the joint APRA-ABS survey of superannuation funds commenced), the retail, public sector and small fund categories have accounted for 80 per cent of the total increase in superannuation assets (figure 2.6).

Figure 2.6 **Contribution to growth in total superannuation assets by fund type, June 1995 to June 2001[a]**
(percentage points)



a Small funds include SMSFs and small APRA funds.

Source: APRA (2001k).

The largest individual contributor to growth in total superannuation assets has been retail funds, with 36 per cent of the growth to the end of the June quarter 2001. Small funds have accounted for 23 per cent of the total growth in superannuation assets over the period. Public sector funds contributed 21 per cent.

Over the same period, the number of individual member accounts has increased by close to 50 per cent. Retail funds have attracted more than 70 per cent of this increase and now manage almost half of all accounts (table 2.5). Industry funds were the only other significant contributor to member account growth, with a 27 per cent share of the rise. Public sector funds were the only group to record a decline in the number of member accounts over the period.

2.5 Operating costs

The costs of operating superannuation funds can be divided into the cost of administration and investment management. According to Clare (2001b), aggregate investment and administration costs in 1999-2000 were around $5.6 billion, equivalent to 1.3 per cent of assets under management. Administration costs accounted for 45 per cent of the total ($2.55 billion). The cost of complying with the SIS legislation will largely be an element of the cost of administration rather than investment management (which would be incurred with or without a regulatory framework).

Administration costs

Superannuation fund administration is the process of receiving and allocating contributions, crediting investment returns, making benefit payments and generally ensuring that the fund is managed effectively and efficiently in accordance with SIS Act requirements. Important elements of these requirements include the nature of information which trustees report to members and regulators.

Aggregate administration costs in the superannuation industry in 1999-2000 were estimated to be equivalent to almost 0.6 per cent of total superannuation assets — on average, around $117 per member account at June 2000 (table 2.8).

As shown in the table, apart from small funds, administration costs per member were estimated to be highest for retail funds ($160 per annum). This reflects the impact of profit margins, the cost of maintaining a sales network for a large part of the retail product network and the provision of a greater range of investment choices and other services for members. Reflecting their not-for-profit characteristics, industry funds had low administration costs ($54 per member). The estimated high cost of corporate fund administration ($147 per member) is likely to be one reason behind the extent of industry consolidation in that segment of superannuation funds over recent years.

Table 2.8 **Administration costs by type of fund, 1999-2000**

Fund type	*Total administration cost*	*Members*	*Administration cost per member*
	$m	'000	$
Industry	350	6 545	54
Corporate	210	1 437	147
Public sector	160	2 722	60
Retail	1 330	8 300	160
Retirement savings accounts	27	300	90
Eligible rollover funds	30	2 000	15
Small funds	400	415	964
Annuities	40	250	150
Total	**2 550**	**21 727**	**117**

Source: Clare (2001b).

Eligible rollover funds, an important avenue for the maintenance of small and lost member accounts (among other things), had the lowest estimated administration cost — $15 per member per annum. Eligible rollover funds, however, provide relatively low rates of return due to their capital-guaranteed nature.

Based on a recent ASFA survey of 60 superannuation funds, there appear to be significant economies of scale in fund administration.[10] In other words, administration costs fall as fund membership numbers increase (table 2.9). This is not surprising given that the impact of large fixed cost items (such as information technology systems) can be spread across a larger number of members, lowering costs per member.

In 1999-2000, respondent funds with more than 100 000 members had average administration costs of less than one dollar per week. This was 70 per cent below the figure for funds with between 30 000 and 100 000 members and less than one sixth the figure for funds with fewer than 1000 members. Significant administration cost dispersion was evident across all fund size classifications.

10 This represented a 20 per cent response rate from the 300 funds which were invited to participate in the survey. The funds which responded managed $62 billion in assets (12 per cent of total superannuation assets). Respondents encompassed 36 corporate funds (accounting for 32 per cent of total corporate fund assets), 6 public sector funds (accounting for 16 per cent of total public sector assets) and 18 industry funds (accounting for 54 per cent of industry fund assets). No retail fund responded.

Table 2.9 **Administration costs per member per week, 1999-2000**
($)

Fund members	*Minimum*	*Maximum*	*Average*
Less than 1 000	2.92	15.43	6.44
1 001 to 10 000	0.55	12.27	4.18
10 001 to 30 000	0.72	3.18	1.49
30 001 to 100 000	0.78	3.28	1.70
More than 100 000	0.47	2.82	0.99

Source: Connor (2001).

Overall, the survey data suggest that fund administration costs have been declining. The average administration cost per member in 1999-2000 was around $66 per annum or $1.28 per week. [11] (This is lower than the aggregate figure in table 2.8 due to the absence of retail funds from the survey data.) This was close to 30 per cent lower than the $1.66 per week administration cost recorded in 1997-98.[12] Administration costs for the two most recent survey years were also significantly less than the approximate $2.05 per member per week recorded in 1992-93.

While administration costs have been declining this does not mean that the costs of complying with the SIS legislation have also fallen. The Institute of Actuaries of Australia cautioned against such a conclusion in their submission to the draft report where it said:

> The report cites evidence that administration costs in the superannuation industry have been declining. Readers may infer from this that costs of compliance with legislation have been declining, or at least not increasing.
>
> In practice compliance costs have steadily increased in the last 15 years, but this has been offset by increasing administrative efficiency due to technological advances. In addition there has been an increase in the average size of funds (excluding self managed funds), as small corporate funds have closed partly due to rising compliance burdens.

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11 Much higher administration costs (around $560 per member per year or around 1 per cent of total assets under management) were found in another study (Bateman and Mitchell 2001) which tested for scale economies in 2000 defined benefit and contribution funds in 1998-99 and compared the results with international evidence. The data set was derived from information provided by superannuation funds in their annual returns to APRA.

12 The 1997-98 survey received responses from 62 funds (37 corporate, 14 industry, 10 public sector and 1 master trust/retail fund) managing some $33 billion in assets or about 8 per cent of the total market. In 1996-97, 100 funds responded (67 corporate, 15 industry and 18 from the public sector).

We believe that administration costs would have fallen much further, had it not been for increasing compliance costs. (sub. DR55, pp. 1–2)

Fund administration is labour-intensive. Based on the ASFA survey for 1999-2000 mentioned above, labour costs for most funds amount to at least 50 per cent of total administration costs. These can take the form of direct labour costs for self-administered funds or indirect costs through fees paid to external administrators (table 2.10). While some larger corporate and public sector funds maintain 'in-house' control over member administration (and investment management), these services are increasingly being out-sourced to specialist service providers. In addition, most funds utilise professional actuarial, legal, custodial and general consulting services in fulfilling their legislative and operational requirements.

Table 2.10 **Fund administration costs, 1999-2000**
(per cent)

	Type of fund		
Cost category	*Corporate*	*Industry*	*Public sector*
Administration staff salaries	29	30	50
External administrators	16	33	1
Rental and occupancy	4	3	8
Information technology	5	6	14
Actuarial/consulting	8	2	1
Audit	3	1	1
Legal	4	1	0
Other accounting/taxation	3	1	3
Other consulting advice	1	2	2
Professional fees	1	2	1
Debt and arrears collection	0	1	0
Training and development	1	1	3
Communication	10	6	5
Travel and accommodation	2	1	0
Other expenses	9	7	10
Total	**100**	**100**	**100**

Source: Connor (2001).

Information technology costs (for internally administered funds) were a significant component, ranging from 5 per cent of total administration costs for corporate funds to 14 per cent for public sector funds. Higher public sector fund information technology costs may reflect the larger number of defined benefit schemes which require extensive salary and contribution histories. Other important cost components included actuarial expenses for corporate funds (which are less likely than large public sector funds to use in-house actuaries) and the costs of communicating with members.

Respondents were also asked to rate the importance of a number of influences on administration costs over the previous year. Reflecting industry concerns regarding the complexity of the legislation, the need for specialist advice was cited as the most important factor in 21 per cent of responses. The next most significant impact was in the area of legislative and regulatory changes, with 17 per cent of respondents nominating this category as the most important factor.

A similar survey conducted for the 1997-98 financial year found that these two factors again featured prominently as influences on administration costs. This earlier survey revealed that 35 per cent of respondents viewed legislative/regulatory change as the most important factor affecting changes in administration costs. The need for specialist advice was nominated by 11 per cent of respondents as the most important factor. Communication with members was also chosen by a number of respondents (17 per cent and 18 per cent in each respective survey) as the most important factor influencing changes in administration costs.

These results indicate the potential for legislative complexity to restrict entry (and therefore competition) in the superannuation industry of both funds and service providers. This can occur because of the level of knowledge and the cost of maintaining technical expertise required in order to comply with the SIS legislation. The results are also relevant to an assessment of the costs of complying with the legislation for those who are currently operating in the industry.

3 The SIS legislation

The SIS legislation is the principal vehicle for prudential regulation of superannuation entities that seek concessional tax treatment. It was introduced in 1993 as part of a package of legislation intended to strengthen prudent management and prudential supervision of superannuation entities. It is voluminous, complex and has been subject to frequent amendment. Participants were generally of the view that the legislation achieves its objectives. However, there were concerns about its overall complexity, as well as the impact on competition and cost-effectiveness of some of its specific provisions.

3.1 Overview of the SIS legislation

This chapter provides an overview of the SIS Act and of participants' general views about it. It also outlines the Act's part in the arrangements to give effect to the Government's retirement incomes policy.

The SIS Act is the principal framework for prudential regulation of 'superannuation entities' — that is, certain superannuation funds, approved deposit funds and pooled superannuation trusts — that seek concessional tax treatment after 1 July 1994 (box 3.1). It replaced the *Occupational Superannuation Standards Act 1987* but preserved elements of that Act which were in force prior to 1 July 1994.

The SIS Act was introduced to Parliament in 1993 as part of a package of legislation that included the *Superannuation (Resolution of Complaints) Act 1993* and the *Superannuation (Financial Assistance Funding) Levy Act 1993*.[1] The stated objective of this package was to give:

> … effect to measures to substantially increase the level of prudential protection provided to the superannuation industry, and [to] represent a substantial strengthening of the security of superannuation savings and in protecting the rights of superannuation fund members. (Parliament 1993, p. 1)

1 Also part of the package were the *Occupational Superannuation Standards Amendment Act 1993*, the *Superannuation (Rolled-Over Benefits) Levy Act 1993*, the *Superannuation Supervisory Levy Amendment Act 1993* and the *Superannuation Industry (Supervision) Consequential Amendments Act 1993*.

Box 3.1 **Superannuation entities covered by the SIS Act**

The SIS Act applies to 'superannuation entities' that must comply with its requirements in order to be eligible for concessional tax treatment for 1994-95 and subsequent years.

The generic expression 'superannuation entity' covers 'regulated superannuation funds', 'approved deposit funds' and 'pooled superannuation trusts'. These superannuation entities are defined as follows:

A **regulated superannuation fund** is a 'superannuation fund' which has a trustee and:

- either the trustee is a 'constitutional corporation' (or 'corporate trustee') or its 'sole or primary purpose' is the provision of 'old-age pensions'; and
- the trustee(s) has elected that the Act is to apply to the fund.

An **approved deposit fund** is an 'indefinitely continuing fund' which is maintained by an 'approved trustee' (essentially a corporate trustee approved by APRA) solely for 'approved purposes'. 'Approved purposes' include receiving, holding and investing certain types of rollover funds until such funds are withdrawn or the beneficiary reaches age 65 or dies.

A **pooled superannuation trust** is a 'unit trust' which has a corporate trustee and which is used only for investing assets including those of regulated superannuation funds, approved deposit funds and life insurance companies.

Sources: CCH Australia (2001a); the SIS Act and Regulations.

The stated objective of the SIS Act itself is contained in section 3 of the Act:

> … to make provision for the prudent management of certain superannuation funds, approved deposit funds and pooled superannuation trusts and for their supervision by APRA, ASIC and the Commissioner of Taxation.

The SIS Act is long, detailed, complicated and prescriptive in some parts. It has more than 30 parts (box 3.2) and 385 sections covering such diverse but inter-related subjects as:

- the structure of superannuation entities;
- trustees' responsibilities;
- the operations of superannuation entities;
- investment, borrowing and lending;
- annual returns of performance and other information to be provided to the appropriate regulator;
- the accounts, statements and audits of superannuation entities;

Box 3.2 The parts of the SIS Act

Part 1	Preliminary
Part 2	Approval of trustees
Part 3	Operating standards for superannuation entities
Part 4	Trustee of superannuation entity to lodge annual returns with the regulator
Part 5	Notices about complying fund status
Part 6	Provisions relating to governing rules of superannuation entities
Part 7	Provisions applying only to regulated superannuation funds
Part 8	In-house asset rules applying to regulated superannuation funds
Part 9	Equal representation of employers and member — employer-sponsored funds
Part 10	Provisions applying only to approved deposit funds
Part 11	Provisions applying only to pooled superannuation trusts
Part 12	Duties of trustees and investment managers of superannuation entities
Part 13	Accounts, statements and audits of superannuation entities
Part 14	Other provisions applying to superannuation entities
Part 15	Standards for trustees, custodians and investment managers of superannuation entities
Part 16	Actuaries and auditors of superannuation entities
Part 17	Suspension and removal of trustee of superannuation entity
Part 18	Prohibited conduct in relation to superannuation interests
Part 19	Public offer entities — provisions relating to superannuation interests and disclosure of information
Part 20	Public offer entities — insider trading
Part 21	Civil and criminal consequences of contravening civil penalty provisions
Part 22	[This part does not exist]
Part 23	Financial assistance to certain funds
Part 24	Facility to pay benefits to eligible rollover funds
Part 24A	Transitional provisions relating to pre-1 July 1995 automatic rollovers of benefits between funds
Part 24B	Provisions relating to the administration by APRA and the Commissioner of Taxation of superannuation funds with fewer than 5 members
Part 25	Monitoring and investigating superannuation entities
Part 25A	Tax file numbers
Part 26	Offences relating to statements, records etc
Part 27	Powers of court
Part 28	Proceedings
Part 29	Exemptions and modifications
Part 30	Miscellaneous
Part 31	Transition to scheme provided for in this Act
Part 32	Additional transitional provisions — tax file numbers

- the responsibilities of actuaries, auditors and other superannuation service providers;
- prohibited conduct in relation to superannuation interests;

- disclosure of information and insider trading in relation to 'public offer' superannuation entities;
- financial assistance to certain superannuation entities;
- monitoring and investigating superannuation entities by the regulators; and
- tax file numbers.

The SIS Act is supplemented by regulations, first made in 1994, and by supplementary material such as decisions, circulars, policy statements and practice notes issued by the regulators (see below). The total volume of this regulatory framework is considerable, amounting to some 1000 pages.

Since its introduction, the SIS Act has undergone many changes, with amendments being enacted at least annually. In fact, since its introduction, the Act has been subject to amendment on at least 32 occasions. In recent years, notable amendments have included:

- in July 1998 — as a partial response to the recommendations of the Report of the Financial System Inquiry (known also as the Wallis report), the transfer of responsibility for the administration of the Act from one regulator (the then Insurance and Securities Commission) to two regulators — APRA, with responsibility for prudential supervision, and ASIC, with responsibility for market integrity and consumer protection;
- in October 1999 — the introduction of a separate regulatory regime for self-managed superannuation funds, involving a reduction of the supervisory levy payable by these funds and the transfer of administrative responsibility for them from APRA to the ATO;
- in December 1999 — the strengthening of part 8, which limits the extent to which a superannuation fund can invest in in-house assets, and of section 66, which prohibits the acquisition of assets from members of a fund and their relatives; and
- in January 2001 — the application of the Criminal Code and the conversion of fault to strict liability for certain offences including those committed by trustees.

Further changes to the SIS Act will occur when the *Financial Services Reform Act 2001* becomes operational in March 2002. The provisions that will be affected include part 18 (which governs certain prohibited conduct in relation to superannuation interests), part 19 (which governs public offer entities in relation to superannuation interests and disclosure of information) and part 20 (which governs public offer entities in relation to insider trading).

The SIS legislation contains many transitional and 'grandfathering' provisions which add to its volume and complexity.

The complexity of the legislation is also due to a number of other factors. It is part of the legislative framework implementing the Government's retirement incomes policy and contains provisions for the prudent management of superannuation entities and prevention of abuse of taxation concessions. The persistent and frequent changes to the legislation have contributed to its complexity. As a result, it is a difficult Act to be familiar with, which raises questions about the costs of complying with it.

Responsibility for administration of the SIS legislation is specified in the Act itself and is shared currently by three regulators. In general terms:

- APRA is responsible for prudential aspects of the legislation. APRA applies a 'risk-based' approach to its prudential supervision of financial institutions, including superannuation entities. These relate to financial risks arising from the nature of the products or services offered by an institution, including credit and market risks, and operational risks arising from the poor performance or operations of the institution, such as deficiencies or breakdowns in internal controls or processes, lack of capacity of the board, technology failures, human errors and dishonesty. They include administration and fraud risks.
- ASIC is responsible for market integrity and consumer protection aspects (such as insider trading and disclosure of information).
- The ATO is responsible for aspects relating to self-managed superannuation funds and taxation (such as tax file numbers). (The ATO is also responsible, among other things, for the superannuation guarantee charge, the superannuation contributions surcharge and the Lost Members Register.)

While the responsibilities of the three regulators are specified in law, in practice there can be some administrative overlap. The regulators have taken steps to address the problem, including entering into memoranda of understanding with each other to define responsibilities more clearly where there is uncertainty or ambiguity.

3.2 Participants' general views of the SIS legislation

The SIS legislation was considered by most participants to be achieving its objectives. The Small Independent Superannuation Funds Association said:

> … the present legislation can be considered to provide a fundamentally sound framework for achieving the broad policy objectives of retirement incomes in Australia. (sub. 13, p. 1)

Further, the Industry Funds Forum stated:

> We support the current regulatory framework because it represents an appropriate balance between on the one hand the need to protect superannuation fund members' savings and the need for broad community support for superannuation, and on the other hand the need to ensure that whatever regulatory regime that is in place is efficient and facilitates an appropriately competitive market. (sub. 10, p. 1)

In response to the draft report, the Australian Council of Trade Unions said:

> The ACTU is in agreement with the Commission's general conclusion that the degree of regulation imposed through SIS and other legislation is justified in light of the prudential requirements of the industry. (sub. DR66, p. 1)

Some participants considered that the legislation did not unduly restrict competition in (or entry to) the superannuation sector or impede the development of new superannuation products or other market developments. For example, as Jacques Martin Industry Funds Administration Pty Ltd said, the legislation 'does tend to accommodate changes in product design' and, furthermore:

> … while there may be barriers to entry to new players in the superannuation industry, these would largely be imposed by the requirement to comply with the taxation legislation, as opposed to the legislation currently under review. (sub. 24, p. 2)

Moreover, in response to the draft report, it stated:

> It has been suggested that the closure of significant numbers of funds is as a direct result of the costs, both direct and indirect, of complying with legislation, however, it is generally not the SIS legislation which serves to deter competition but the tax legislation and, in particular, the surcharge. (sub. DR62, p. 3)

The compliance costs attributable to the legislation, while onerous, were also considered by many other participants to be less than those arising from complying with tax legislation, particularly the administration of the superannuation contributions surcharge. For example, as William M Mercer noted:

> Compliance effectively impacts on every transaction in some way or other. Whilst compliance with SIS is a significant issue, compliance for tax purposes is even more significant. By far the greatest compliance issue is the superannuation surcharge. (sub. 8, p. 7)

Nonetheless, despite this overall support, concerns were expressed about the legislation, particularly about its increasing complexity. As the Association of Superannuation Funds of Australia said:

> Despite the strong support for the conceptual basis upon which the superannuation legislation is premised, [the Association] is concerned about a creeping prescription and a complexity within the SIS regime and its potential to increase costs and inhibit competition both between superannuation funds and between service providers of superannuation funds. (trans., p. 4)

The Queensland Government Superannuation Office articulated some of the reasons for the complexity of the legislation as follows:

> Whilst the general principles underpinning the SIS legislation are appropriate, the "grandfathering" of certain initiatives, the interaction with other Commonwealth legislation such as taxation and social security, and the distribution of regulatory functions, have all contributed to a more complex regime than was perhaps anticipated. (sub. 41, p. 3)

The Industry Funds Forum noted that 'the legislation is complex by virtue of the subject matter' (sub. 10, p. 3).

Also, the Small Independent Superannuation Funds Association stated:

> … the legislation seems to have become bogged down in too much detail as a result of all the amendments to it. Many of these amendments have only served to introduce restrictions, more prescriptive measures and complexities to the superannuation system. (sub. 13, p. 1)

The focus of most participants' submissions was on specific areas of the legislation that were identified as imposing unnecessary compliance costs.

3.3 The SIS Act and retirement incomes policy

More generally, the SIS Act and the other legislation under review are part of the arrangements giving effect to the Government's retirement incomes policy. As APRA said:

> The answer … [to why superannuation entities require prudential regulation] relates to the overall significance of superannuation to the bulk of the community, the fact that it is compulsory and now forms a central part of the Government's broader retirement incomes policies. To engender public confidence in the system, it is therefore deemed appropriate, by governments and the community alike, that the level of regulatory intervention, and overall prudential safety and soundness, should be higher than for other managed funds. (sub. 36, p. 1)

Under this policy, superannuation has been chosen as the vehicle through which the Government uses a combination of compulsion and incentives to ensure widespread private provision of retirement incomes. As outlined in chapter 1, the main instruments are the requirement under the superannuation guarantee scheme for employers to make contributions to regulated superannuation funds for the benefit of their employees and the favourable taxation treatment of investments in those funds. The use of such measures necessarily requires legislation regulating the conduct of superannuation entities.

A non-legislative approach (such as industry code of conduct) would expose the management of superannuation assets to more significant risks and would be unlikely to be acceptable to the community — especially now that these assets represent such a large and rising proportion of private sector wealth. While information asymmetries between providers of superannuation and fund members do not seem substantial, there would be more scope for harmful 'externalities' in the absence of legislation. For example, the increased risk of losses of fund members' assets could have substantial implications for fiscal policy if the result was greater reliance on the age pension scheme.

The objectives of the SIS Act are clearly specified and are an appropriate expression of the key purpose of prudent management and prudential supervision regulation of superannuation funds. In particular, the Act provides a framework within which trustees are required to establish and operate funds in the interests of their members. It also provides fund members with a measure of confidence about investing their savings in the form of superannuation, especially those which have been compulsorily redirected from current earned income and consumption choices.

Some developments in the superannuation industry, such as the closure of significant numbers of funds, might suggest that the SIS legislation is deterring competition. On the other hand, some indicators could suggest that any such influence is not major. For instance:

- investment options and new products available to fund members have been growing, and the number of funds remains large;
- services available to members have been modernised and expanded;
- advertising by retail and industry funds as they compete for new members has increased noticeably; and
- fund administration and investment management costs have been declining.

The SIS legislation thus does not seem to be restraining competition to the disadvantage of fund members. Nevertheless, a consequence of the legislative framework for prudent management of superannuation entities is some restriction of competition in the supply of certain superannuation services, as well as the imposition of costs on those required to comply with the legislation. These matters are discussed in subsequent chapters.

4 SIS legislation: restrictions on competition

There are restrictions in the SIS legislation as to who can be a trustee, a custodian, an auditor and an actuary for the purpose of undertaking prescribed tasks in respect of superannuation funds. The Commission finds that the benefits of the restrictions mostly outweigh the costs. Further, there is little likelihood that the objectives of the legislation could be achieved satisfactorily without such restrictions. Nonetheless, the Commission has identified some aspects of the restrictions which could be modified to improve their effectiveness.

This chapter examines parts of the SIS Act that restrict the provision of some services to superannuation entities — namely, functions performed by trustees, custodians, auditors and actuaries. The following sections:

- describe the restrictions;
- identify the objective(s) of the restriction;
- analyse the likely benefits and costs of the restriction(s); and
- identify possible scope for improvement in the cost-effectiveness of the current arrangements.

4.1 Trustees

Trustees are the sole responsible entity for the operation of superannuation funds.

The SIS Act has the effect of dividing trustees into two types — trustees that need to be approved by APRA (approved trustees) and all others. The entry requirements for each differ (as discussed below). The distinction is important because the SIS Act requires different fund types to have different trustee structures.

Public offer entities, small APRA funds, approved deposit funds and pooled superannuation trusts must have an approved trustee. An approved trustee may be independent of members or satisfy the equal representation rules (see section 6.1). Approved trustees of most, if not all, public offer industry funds use the equal representation structure rather than the independent trustee option.

Other types of funds — self-managed superannuation funds (SMSFs), and non-public offer standard employer-sponsored funds (which include corporate and most industry funds) — need not have an approved trustee, provided they meet certain rules for member representation on the trustee board. For example, in the case of standard employer-sponsored funds, the trustees must satisfy the equal representation rules.

The only entry restriction on who can be a trustee of most superannuation entities is that they are not a 'disqualified person' (box 4.1). As a trustee of a SIS-regulated superannuation entity, however, they are responsible for ensuring that all the provisions of the SIS Act are complied with.

Box 4.1 **The disqualified person test**

A 'disqualified person' must not intentionally be or act as a trustee (or as a responsible officer of the corporate trustee) of a superannuation entity. Intentional contravention of this requirement could warrant imprisonment (sec. 121).

An individual will be considered disqualified if he or she is convicted of an offence involving dishonest conduct, has had a civil penalty imposed, is insolvent or has been explicitly disqualified by APRA (sec. 120).

A corporation is a disqualified person if it knows, or has reasonable grounds to suspect, that a person who is acting as a responsible officer of the corporation is a disqualified person, a receiver has been appointed in respect of property beneficially owned by the corporation, an official manager has been appointed in respect of the corporation, a provisional liquidator has been appointed in respect of the corporation, or the corporation has been wound up (sec. 120).

APRA may disqualify an individual if there has been a serious contravention of the legislation or if the individual is not a 'fit and proper person'. Similar provisions apply to an individual who is a responsible officer of a corporate trustee (sec. 120A).

A person who is a disqualified person due to minor dishonesty convictions may apply to the Regulator for a waiver of the disqualified status (sec. 126B to 126F).

For approved trustees, the entry restrictions are more extensive. As well as being subject to the disqualified person test, they must obtain approval from APRA and continue to meet the regulatory requirements which accompany that approval.

Before it can give approval, APRA must be satisfied that the applicant:

- can perform, in a 'proper manner', the duties of a trustee — that is, the applicant must demonstrate, for example, that it has in place the necessary skills and competence, appropriate systems and controls, and achievable budgets and targets; and

- either has at least $5 million in net tangible assets (NTA), or an ‘approved guarantee’ of at least $5 million, or a combination of NTA and approved guarantee of at least $5 million;[1] or
- agrees to comply with requirements relating to the custody of the assets (sec. 26).

Quite a large proportion of approved trustees operate on the basis of complying with the custody requirements, as opposed to holding $5 million NTA (or equivalent form) in their own right (sub. 49, part 3).

In addition to the requirements specified in the SIS Act, approved trustees must comply with the conditions specified in the instrument of approval issued by APRA (box 4.2).

Box 4.2 **Conditions of APRA’s instrument of approval to trustees**

APRA issues an instrument of approval to successful applicants. The ‘standard draft’ instrument of approval contains nine sets of conditions. Among these, for example, are:

A13: the minimum number of directors of the trustee must be four, of which three must be Australian resident.

A15: the trustee must not engage in any business or commercial activity (other than as a trustee of a superannuation entity) unless that business or commercial activity is necessary or reasonably incidental to the trustee’s activities, or the trustee carried out that type of activity at the time the approval was made, or the activity was approved by APRA.

B1 to B3: the trustee must maintain, at all times, a formal and adequate contingency plan setting out the manner in which it proposes to address any major administrative difficulties such as crimes or system failures. The trustee must maintain adequate levels of insurance against potential liabilities incurred as a result of any breach of its professional duty as trustee. The trustee must maintain adequate levels of insurance to cover any material damage and consequential loss.

D1: the approved trustee must maintain at all times ‘eligible assets’ (that is, net tangible assets) of at least $100 000 and liquid assets of at least $100 000. (These amounts need not be separate.)

D2 and D3: only one custodian, which must be independent of the trustee, may be appointed.

Source: APRA (2001a).

1 The $5 million amount was first prescribed in the Superannuation Industry (Supervision) (Approval of Trustees) Regulations 1993 (reg. 4) and then in the Superannuation Industry (Supervision) Regulations 1994 (reg. 3.03). Since then, the value of the $5 million requirement has been eroded by inflation of some 20 per cent.

There are nine groups of conditions within the standard instrument of approval. These may be subject to additional specific conditions tailored to the circumstances of the particular approved trustee. About 70 per cent of approvals contain specific conditions (sub. 49, part 3). Since 1999, APRA has used the instrument of approval to require approved trustees of most small APRA funds to have $5 million NTA in their own right, regardless of whether or not they use an external custodian. Also, APRA has required all approved trustees which themselves do not have $5 million NTA to act only as a trustee for a defined list of superannuation entities.

As at 10 December 2001, there were 153 approved trustees, of which 44 are permitted to be trustees for small APRA funds (APRA 2001f). The public offer funds managed by approved trustees include retail funds, industry funds which have elected to become public offer funds and funds where the trustee is at arm's length from the members but does not operate for commercial gain — such as the Victorian Solicitors' Superannuation Fund (box 4.3). Approved trustees are responsible for about 75 per cent of the superannuation entities supervised by APRA and hold more than $160 billion in assets (table 4.1). The five largest approved trustees are estimated to account for around 40 per cent of total assets held by such trustees — equivalent to about 10 per cent of total superannuation assets — and for 50 per cent of members of the large retail funds (Clare and Connor 2001, p. 1).

Box 4.3 **An example of an approved trustee which is independent of members and does not operate on a commercial basis**

The Victorian Solicitor's Superannuation Fund was established in 1960 to provide superannuation for self-employed solicitors. At 30 June 2001 it had 323 members and $28.1 million in assets.

Upon the introduction of the SIS Act, it was classified as a public offer fund (as it did not satisfy the definition of a standard employer-sponsored fund).

The trustee is independent of members, consisting of people appointed by the Law Institute of Victoria. The trustee has share capital of $14 and does not operate on a for-profit basis. It meets the approved trustee rules by placing custody with an external party which satisfies the $5 million NTA requirement. It has been exempted from condition D1 relating to liquid and eligible assets. Instead, under the instrument of approval, the trustee has been required to apply those requirements to the administrator through contractual arrangements.

Source: Law Institute of Victoria (sub. DR52).

Table 4.1 **Funds with approved trustees, July 2001**

Type of fund	*Number of funds*	*Amount invested*	*Number of members*	*Average size of fund*
		$m	'000s	$m
Public offer funds	399	154 403	12 363	387.0
Small APRA funds	7 654	2 278	10	0.3
Other regulated funds	440	4 563	2 778	10.4
Total funds with approved trustees	**8 493**	**161 244**	**15 151**	**19.0**

Source: SSCSFS (2001a).

Assessment of entry restrictions for trustees

Where trustees are dealing with their own assets, as in the case of SMSFs, the entry condition is minimal — the disqualified person test. The objective is to prevent people who have been convicted of dishonest conduct from becoming trustees. The same minimal entry condition applies to trustees of employer-sponsored funds, where rules also apply governing member representation on the trustee board. In both cases, there is no higher test of the requisite trusteeship skills on entry other than a willingness to serve in that capacity, even though employer-sponsored funds deal with assets of their employees.

The issue is whether the disqualified person test unnecessarily excludes people who could be satisfactory trustees. One participant submitted that, on the basis of his experience and research, the test can unreasonably exclude potentially satisfactory trustees (trans., pp. 312–18). He noted that it can exclude people convicted of minor offences of dishonest conduct many years earlier, that there are no spent conviction provisions and that the SIS Act provisions are harsher than Corporations Law. The Commission notes, however, the merits of the objective of the provision and that the SIS Act allows APRA to waive disqualification.

In fact, the reverse problem may be of more concern. Persons who are convicted of dishonest behaviour while acting as a trustee may not relinquish their trusteeship voluntarily, as they are required to do under the disqualified person provisions of the SIS Act. It is possible that APRA would not become aware of a problem of this kind until the person is convicted. For example, APRA announced in December 2001 that it had replaced a trustee because he had become a disqualified person, having been convicted in August 1999 on eight charges of forging and uttering documents (APRA 2001d). The concern is the potential risk to superannuation assets in the intervening period while such people continue to have trusteeship of other people's assets.

Also relevant is the issue of whether the disqualified person test, on its own, is a sufficient entry requirement for non-approved trustees. One view is that such an open approach is appropriate and beneficial because it opens the field to a wide variety of people capable of fulfilling the role of a trustee. (The trust focus and trusteeship are examined in section 6.1.)

An alternate view is that, in light of the difficulties that some trustees have faced in operating superannuation entities, there is a need to enhance the entry requirements. According to this view, there would be better management of funds if entry was restricted to more qualified persons. The Commission notes that elsewhere in the financial sector more stringent entry conditions apply to those seeking to manage other people's money.

This raises the question of whether, in addition to meeting the disqualified person test, any operational requirements should also be imposed on such trustees. This issue is discussed further below.

Rationale for and objective of the additional entry requirements for approved trustees

Where the people involved in providing trusteeship seek to do so on a commercial basis, otherwise solicit contributions from the public or seek to provide trusteeship on an arm's length basis, then the approved trustee requirements apply. In these situations, there is the potential for the trustees to act in their own interests at the expense of the members. The SIS Act addresses this risk by specifying certain minimum requirements for approved trustees. As the Association of Superannuation Funds of Australia (ASFA) said, 'Given the nature of these entities and the business they are conducting, divergence [of regulatory requirements] in this area is deemed desirable' (sub. 15, p. 7).

The broad objective of the (package of) entry requirements for approved trustees — in the legislation and the instrument of approval — is to ensure a level of adequate competence and capacity for prudent management, as well as a commitment to the task and to members' interests. Each element of the entry requirements has its own purpose. For example, APRA's examination of business plans and experience of the trustee may increase the likelihood that the trustee is capable. With respect to the NTA requirement, ASFA said that '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' (trans., p. 267). Another role for the NTA is that such substance provides a signal of commitment to the task with an increased likelihood of ensuring that members' best interests are looked after.[2]

Benefits and costs of the current entry requirements for approved trustees

The benefits of the entry requirements for approved trustees in ensuring an adequate capacity for prudent management of superannuation entities are not readily quantifiable. The requirements have not unduly constrained competition. They have contributed to the low rate of trusteeship failure that has occurred. They have also contributed to public confidence in superannuation and aided taxation concessions in encouraging voluntary savings in this form for retirement income purposes. In addition, they have facilitated the prudential supervision of superannuation entities in so far as APRA has a recognised group of trustees subject to codified requirements.

The main costs of the entry requirements for approved trustees (which do not use an external custodian) are the cost of carrying additional capital and the possible exclusion of potential trustees from the industry.

Assessment

In assessing the stringency of the entry requirements placed on approved trustees and any consequent adverse affects on competition — such as pricing inefficiency, operating inefficiency, poor service quality, lack of innovation or poor investment performance — the Commission has considered the following:

- there are some 150 approved trustees;
- the current market for retail funds (which require an approved trustee) exhibits signs of competitive behaviour:
  - administration costs/trustee fees for retail funds have declined;
  - many retail funds advertise on a regular basis for contributions from the public; and
  - there is innovation, such as in the design of investment strategies and offering electronic viewing, and interactive management of their savings, to fund members;

[2] This is consistent with two of the underlying principles for the proposed financial requirements for licensing under the *Financial Services Reform Act 2001* — which includes a NTA requirement. First, it helps to ensure that there is a financial buffer which decreases the risk of a disorderly or non-compliant winding-up if the business fails; and, second, that there are incentives for the owners to comply through risk of financial loss (ASIC 2001b).

- there has been little entry or (voluntary) exit of approved trustees since 1994-95. The Insurance and Superannuation Commission approved 124 approved trustees in 1993-94 when the SIS Act became operative and a further 45 were approved in 1994-95. There have been some revocations since then (sub. 49, part 3). Lack of new entrants could be an indication that the entry requirements are quite stringent, which could raise the costs of being an approved trustee and flow through to fees. On the other hand, the market may be so competitive that, at this stage, it offers little incentive for new competitors; and
- there have been few formal rejections of applications. This may suggest that the entry requirements are 'easy' for any willing applicant. Alternatively, it could be that few formally apply once informal discussions with APRA indicate that the applicant would find it difficult, or be unable, to meet the entry requirements.

While the indicators present a mixed picture, the Commission considers that the entry requirements are not overly stringent, and that the market is competitive. Moreover, there would be firms with sufficient capital and capable personnel that could enter if some incumbents were exhibiting signs of earning excessive returns or providing poor service.

The Commission has also considered, in particular, whether condition A15 (box 4.2) — relating to the conduct by approved trustees of other business activities — had adversely affected competition in the provision of other products and services, such as managed investment schemes. Finlaysons considered that condition A15 was 'unnecessary, overly bureaucratic and anti-competitive' (sub. 17, p. 4). APRA advised that the condition was introduced because of growing concerns by the Insurance and Superannuation Commission and APRA about the capacity of approved trustees to manage effectively and prudently a wide range of activities, many of which were outside the superannuation sector (sub. 49, part 1).

In the draft report, the Commission, after reviewing the purpose and application of condition A15, commented that any constraint on competition by application of it was unlikely to be of sufficient magnitude to lessen competition in either superannuation or other markets. The Commission has received no comment on this assessment, suggesting that condition A15 has not been applied in an unduly restrictive manner. Therefore, the Commission has made no recommendation for change; the condition is useful and APRA should continue to have discretion in this matter.

Overall, the current entry requirements for approved trustees are likely to have facilitated the prudent management and prudential supervision of superannuation funds. This benefit is assessed as exceeding the costs of restricting entry, which are likely to be quite small. The entry requirements need reduce the risks of less prudent management by only a small amount in order to generate a net benefit.

While the current arrangements for approved trustees have been assessed as providing benefits to the community, there is, in the Commission's view, scope for improvement in specific elements of the current arrangements to make them more cost-effective.

Scope for improvement

The areas identified for improvement relate to the NTA requirement for approved trustees and to the operational requirements for all trustees regarding liquidity and risk management.

Net tangible assets requirement for all approved trustees

In its draft report, the Commission argued that there was a case for strengthening the NTA requirement for approved trustees, principally on the basis that there has been extensive use of the custodial concession, that the concession has proved inadequate in some circumstances — such as those documented by the Senate Select Committee on Superannuation and Financial Services (SSCSF 2001b) — and that, therefore, all approved trustees should have financial substance in their own right.

There are particular weaknesses in the current NTA requirements. As at August 2001 only 56 trustees, out of a total of 159, were approved on the basis of having at least \$5 million NTA (or equivalent form) in their own right (sub. 49, part 3). Nearly all of these are approved trustees of small APRA funds. While the Act enables approved trustees to have less than \$5 million NTA (or equivalent form) if they place custody of the assets with an independent custodian, the use of this arrangement is perhaps more widespread than envisaged or desirable. The Commission considered that, as a general rule, an approved trustee, as the responsible entity, should have some financial 'substance' in its own right, regardless of custody arrangements. A substantial capital commitment provides the wherewithal to deal with significant matters for which the trustee is responsible, and also is a measure of the trustee's commitment to the efficient conduct of the entity. It imposes a commercial discipline.

The Commission's view is consistent with the view expressed by APRA that 'the \$5 million requirement includes legislative concessions that makes its efficacy questionable' (sub. 36, p. 10). The Senate Select Committee on Superannuation and Financial Services reported that a similar view had been put to it by APRA:

This requirement has been examined following the CNA [Commercial Nominees of Australia Pty Ltd] matter, with APRA considering that an approved trustee should have its own capital. (SSCSFS 2001a, p. 26)

While APRA stated that there is a case for a ‘more robust and risk-focused minimum capital regime than the flat $5 million charge applied at present’ (sub. 36, p. 10), it has not stated publicly what this would specifically involve.

In its draft report, the Commission proposed that:

- all trustees should be required to have a specified minimum amount of NTA (or approved guarantee or combination thereof) regardless of their custodial arrangements; and
- approved trustees which use custodians should not be required to have more than the specified minimum.

Participants’ views

Some participants questioned the role of a NTA requirement — that is, whether it adds to greater security for members over and above other requirements on approved trustees (such as the covenants, custody, liquidity, contingency plan, insurance requirements and the disqualified person test). They doubted that there was evidence of ‘failure’ in the funds overseen by approved trustees and questioned the underlying reason for such failures as have occurred. Attention was drawn to the class of funds which APRA has publicly identified as of significant concern — namely, small corporates — and the nature of the concerns about these funds (such as inappropriate investment strategies). This criticism applies equally to both the current arrangements and any strengthened arrangements. For example, Corporate Super Association argued:

> The practical value of the required asset backing for approved trustees is … questionable. In the event of systems failure or other collapse, the required asset base is unlikely to be adequate to make good the damage. The required capital backing for these entities serves more as a barrier to entry to the approved trustee function, than as a practical source of financial insurance. (sub. 12, p. 16)

The Law Institute of Victoria (in the context of non-commercial approved trustees) questioned whether ‘additional’ regulation is needed beyond the trust covenants:

> In the case of directors who need a carrot or a stick to cause them to act prudently, they have a duty under the covenants in sec. 52 of SIS, and a risk of incurring personal liability (civil or criminal) for failing to act honestly or prudently. Accordingly, if SIS were to require a trustee company to establish an artificial capital base for which it has no operational need, the mere existence of that unwanted capital would be most unlikely to be conducive to more prudent management. (sub. DR52, p. 9)

Indeed, it was argued by Jacques Martin Industry Funds Administration Pty Ltd (Jacques Martin) that:

> … the existence of a certain level of NTA may bring with it commercial pressures to increase the effective rate of return on such capital which has been effectively "tied up" in the business. In certain circumstances, such commercial considerations may be in direct conflict with prudent management. (sub. DR62, p. 5)

Some participants also argued that the Commission should have distinguished between the entry requirements of for-profit and not-for-profit approved trustees, although the legislation does not use these terms. Their argument was that approved trustees of not-for-profit public offer funds — that is, industry funds and funds such as the Victorian Solicitors' Superannuation Fund — do not pose the same risks as other funds with approved trustees. In their view, the absence of shareholder interests, together with member representation on most not-for-profit approved trustee boards, means that there is no potential conflict of interest between members and the trustee. Thus, they saw no need to require the trustees of such funds to have their own capital in order to ensure that they put members' interests first. Jacques Martin said that a 'more suitable alternative to the requirement to have a NTA would be to mandate sufficient levels of suitable insurance cover to be held by the trustee' (sub. DR62, p. 5).

A related practical issue raised was how a not-for-profit approved trustee, which was a 'shell' (or $2) company, could meet the NTA requirement or 'equivalent' guarantee. For example, the Law Institute of Victoria pointed out that:

> There is no corporate sponsor or commercial financial services provider who would contribute capital to fund a minimal capital requirement or an approved guarantee if such a requirement were now to be imposed on them. … a not-for-profit trustee is not in a financial position to meet the cost of such a guarantee, nor does it have any assets of its own that could be charged as collateral to support such a guarantee. (sub. DR52, pp. 7–8)

The Law Institute of Victoria argued that the only source would be members' assets and estimated that in the case of the Victorian Solicitors' Superannuation Fund a $2 million guarantee would cost $119 per member per year (sub. DR52, p. 11). In terms of assets under management, this would be equivalent to 1.9 per cent.

Other participants, besides APRA, supported a capital adequacy requirement. The Trustee Corporations Association of Australia said:

> We believe that approved trustees for small APRA funds and public offer funds should be required to have appropriate financial underpinning. This should comprise a meaningful minimum level of NTA (or approved guarantee or combination thereof), plus adequate insurance. (sub. DR69, p. 5)

The Institute of Actuaries of Australia offered in-principle support for a change in the NTA requirement:

> … some review of the structure of the capital requirements for Approved Trustees, for example, to reflect APRA's suggestions in relation to a more robust, risk-focused minimum capital regime than the current flat $5 million requirement, may be appropriate. (sub. DR55, p. 2)

Assessment of scope for improvement

The Commission considers that a NTA requirement is likely to be beneficial to member interests by adding to the trustee's commitment to the task and ensuring that the trustee has some capacity to conduct its affairs and facilitate orderly change in trusteeship, should the need arise. The Commission does not agree with the view that a NTA requirement may compromise the trustee's duty to members, because of a need to earn a return on the capital. Earning a satisfactory rate of return on the capital may depend on reputation as a good trustee, which would be adversely affected if it is known that members' best interests are neglected.

The Commission also remains of the view that widespread reliance on the custodial concession is not consistent with prudential objectives and that all approved trustees should be required to have a specified minimum level of substance in their own right. This is consistent with the requirement under the *Managed Investments Act 1998*, under which responsible entities of managed investments, must have at least a specified minimum amount of NTA.[3] There has been less than satisfactory performance by some approved trustees and the present NTA requirement is inadequate as a means of screening for prudent trusteeship. Accordingly, the Commission considers that the same principle should apply to all approved trustees who manage superannuation assets.

The Commission does not see a case for weakening the above principle by exempting so called not-for-profit approved trustees. Where the trustee is independent of the members, the not-for-profit label is of secondary comfort to those members. There is also an issue of competitive neutrality — it is not clear why not-for-profit funds should be given a legislative advantage over public offer retail funds in attracting contributions from the public. In sum, the Commission considers that all approved trustees should be subject to the same NTA requirements.

3 Under the Managed Investments Act, a responsible entity must hold, at all times, a minimum of NTA of 0.5 per cent of the value of the assets of the registered schemes they operate, with a minimum requirement of $50 000 and a maximum of $5 million.

On the practical issue of how to apply a NTA requirement to not-for-profit ($2 shell) approved trustees, the Commission notes the option of a guarantee.

In light of the above matters, the Commission has concluded that approved trustees, which do not use an external custodian, should continue to have $5 million NTA (or equivalent) in their own right, as under the current law. However, the legislation should be changed to require all other approved trustees, which do not have custody themselves, to have a minimum level of NTA (or equivalent). The amount of the NTA should be determined in a manner similar to the formula currently used for responsible entities of registered managed investment schemes under the Managed Investments Act. This involves specification of the NTA as a proportion of the assets under management, with specified minimum and maximum amounts.

RECOMMENDATION 4.1

The net tangible assets requirement for approved trustees should be strengthened through legislative amendment. All approved trustees which use an external custodian should be required to have an amount of net tangible assets (or approved guarantee or combination thereof) that is related to the value of assets under trusteeship, subject to specified minimum and maximum amounts in a manner similar to that required under the Managed Investments Act. Approved trustees which do not use custodians should continue to be required to have $5 million net tangible assets (or equivalent) in the their own right.

Trustee liquidity

In its draft report, the Commission proposed that all approved trustees should have adequate liquidity and working capital in order to fund their own operational requirements and to cover the risk of operational failures faced by the superannuation funds which they manage.

The Commission considered that the current arrangements were inadequate. Under condition D1 in the APRA draft instrument of approval, an approved trustee which uses an independent custodian is required to maintain at all times eligible assets of at least $100 000 and liquid assets of at least $100 000. APRA said that the condition was introduced to give ‘the then ISC some comfort that the trustee itself had some ready resources to address any administration or computer system problem’ and that the amount of $100 000 was based on an ‘estimate’ of the cost of replacing administration systems for a ‘reasonable sized fund’ (sub. 49, part 1). The Commission was told that, in practice, the instrument of approval has sometimes been used to require higher amounts or to exempt the approved trustee and apply the requirement instead to the administrator (box 4.3).

The Commission considered that the amounts in condition D1 needed to be reformulated so that they reflect current operating expense levels and appropriate provisioning for replacing record keeping systems, and provide for other contingencies. The Commission argued further that given the importance of these prudential requirements, they should apply equally to all trustees — whether approved or not — and should be recognised in the legislation.

Participants' views

Participants disagreed with the Commission's draft recommendations, for a variety of reasons.

Finlayson's raised a consistency issue as between approved and other trustees in respect of condition D1:

> As the trustee duties for a corporate fund and a public offer fund are largely the same … it is difficult to see how an additional asset requirement for Approved Trustees [of public offer funds] could possibly relate to their ability to perform their duties as a trustee. (sub. 17, p. 3)

The Institute of Actuaries of Australia said it had some sympathy for this view (sub. DR55, p. 2) and Jacques Martin agreed (sub. DR62, p. 8).

The Trustee Corporations Association of Australia commented that 'Provided NTA is appropriate, we do not see a need for a separate "operating" capital requirement' [for approved trustees] (sub. DR69, p. 5).

Participants argued that, rather than require the trustee or the fund to hold operating capital, operational risks associated with service providers could be addressed by ensuring that the service provider has the necessary capability for delivering the service and for dealing with contingencies. The Trustee Corporations Association of Australia said:

> We do not see it as appropriate to attempt to impose capital requirements on a superannuation fund itself.
>
> However, the supervisory framework should ensure that the various commercial parties involved in the operation of a fund [trustees and service providers] do have adequate capital and insurance to address operational risk, including lack of compliance with relevant prudential requirements. (sub. DR69, p. 5)

Participants questioned the practicality of 'shell' trustee structures having to meet an operating capital requirement themselves. They pointed out that there are other mechanisms for dealing with the concerns. For example, the Institute of Actuaries of Australia said:

> … 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. (trans., p. 244)

Jacques Martin considered that insurance was one such alternative to operating capital:

> … where the approved trustee of a not-for-profit industry fund has out sourced their administrative functions, the requirement *"to have adequate liquidity and working capital in order to fund operational requirements and to cover the risk of operational failures"* lies with the administration company. Consideration could be given to mandating suitable insurance in lieu of a requirement for operating capital. (sub. DR62, p. 8)

In respect of the option of the employer meeting the requirement, instead of the trustee, it was pointed out that fewer employers now subsidise fund operations. The Institute of Actuaries of Australia acknowledged the point that, if employers met the operating capital requirement, there may be reduced independence of the superannuation entity and a higher risk facing members in the event that the employer ran into difficulties and could not separate the running of the fund from the running of the employer's business itself (trans., p. 254). ASFA also questioned whether independence would be compromised if the employer paid (trans., p. 266). There is also the complication of there being many employer sponsors of an industry fund.

Participants also questioned the option of members paying directly, either by way of a contingency reserve within the fund itself or by placing capital with the trust company. PricewaterhouseCoopers said:

> The trustee has powers under SIS to, I guess, increase administration expenses and effectively that comes out of members' money. ... I think potentially what we're talking about here is having capital for the sake of having capital, quite frankly. We could end up with a situation where all funds have capital and it just sits there unnecessarily and I think we're really talking about isolated cases of things going wrong. I think we need to sit back and put it all into context. (trans., p. 437)

Doubt was also expressed about whether this option was the least-cost mechanism for obtaining cash if needed. Some participants questioned why a specific reserve should be required to be held for a situation that may never occur when there are effective alternatives — for example, trustees could draw on administration or investment reserves or have a line of credit available. The Law Institute of Victoria considered that members would prefer to 'take the chance':

> … I would have thought that if members were given the choice of having capitalisation of the trustee for which they would bear the cost as a certainty or the possibility that they might have to have an administrator who falls over and expense incurred that way,

> they would probably go for the latter case, because [the former is] wasted money. (trans., p. 446)

On the question of whether operating capital should be a means for dealing with operational risks, PricewaterhouseCoopers commented:

> The other key issue there I guess is the whole issue of the underlying quality of different organisations and superannuation funds … What sort of processes do they have in place, from a risk management of view … So for example those organisations that do have very strong fund and corporate governance processes in place, strong internal audit functions, risk management functions and so on … perhaps they don't need as much capital for operational risk as some of the others ... . (trans., pp. 427–8)

Assessment of scope for improvement

The above discussion highlights two important elements of robust trusteeship:

- approved trustees need to have adequate liquidity to cover their own business operating expenses; and
- all trustees — both approved and others — need to assess continuously, and guard appropriately against, all risks faced by superannuation funds (not just operational risks).

Generally, it would be expected that commercially orientated approved trustees, with sound business plans and acting in their own interest, will provide adequately for their ongoing business expenses. However, this may not always be the case. If approved trustees do not have sufficient liquidity to meet short-term commitments, there is a greater risk that they may not provide prudent trusteeship in compliance with the SIS Act.

The Commission considers that there would be net benefits from requiring approved trustees to maintain some minimum level of liquid assets, as is the case for responsible entities of managed investments. The 'additional' costs of such a requirement will depend on the extent to which such trustees already hold sufficient liquidity on a voluntary basis for management purposes and/or as part of meeting the NTA requirement.

RECOMMENDATION 4.2

The eligible and liquid assets requirements for approved trustees should be revised so as to require all approved trustees to have sufficient liquidity. The requirement could be cast in terms similar to that required of responsible entities under the Managed Investments Act.

Trustee risk management strategies

The awareness and management of risk is a key element of prudent management. All trustee entities face a variety of risks in respect of the superannuation funds for which they are responsible. These include investment, operational and governance risks.

Trustees can address those risks in a variety of ways. For example:

- internal procedures in respect of funds' management responsibilities (such as ensuring awareness of risks) can help to avoid oversights;
- investment diversification is a means of mitigating market risk;
- in the case of out-sourced service functions (such as administration), due diligence can be used to address all material factors which could have an impact on service providers' ability to perform the activities, including their financial and technical ability; and
- ensuring that service providers have appropriate insurance arrangements can reduce the risk of costly disruption to management of members' accounts.

To the extent that some trustees may not adequately assess and provide for the risks faced by superannuation funds for which they are responsible, there would be benefits from a mandatory minimum requirement. The benefits of a such an approach include:

- increased assurance that all sources of risk are identified and that appropriate risk management strategies are implemented;
- scope to tailor the most cost effective solution to the circumstances of each fund, especially for 'shell' trustees that outsource all supporting functions; and
- a heightened cognisance and diligence by trustees towards risk awareness and management.

There are, however, some possible disadvantages associated with a mandated risk assessment approach:

- there is no guarantee that the risk assessment will be done to the standard expected, or complied with; and
- risk assessment, documentation, monitoring, and compliance auditing involve costs — although many trustees are already doing this to some extent.

The Commission considers that the benefits of a mandated risk assessment process are likely to outweigh such potential disadvantages. All trustees — both approved and others — should be required to prepare a risk management strategy for each fund for which it is responsible. This strategy should identify the variety of risks faced by the fund and the means by which these risks are to be addressed. This should be submitted to APRA for approval so as to ensure that superannuation funds do not operate without having considered the risks involved. Further, in order that risk assessment remains an ongoing process, and to ensure that the strategy is implemented, the risk management strategy and the processes for complying with it should be audited each year as part of the compliance audit.

RECOMMENDATION 4.3

All trustees should be required to prepare a risk management strategy which addresses the various risks faced in the management of superannuation funds. Trustees should be required to obtain approval of these strategies from the Australian Prudential Regulation Authority. The strategy and the processes for complying with it should be audited each year as part of a fund's compliance audit.

4.2 Custodians

Custodianship of superannuation funds' assets (such as share scripts) involves the physical handling, transfer, storage and accounting for changes in holdings.

Trustees have the primary duty to be holders of all assets in superannuation funds. However, trustees are able to appoint a custodian to hold the assets on their behalf. Indeed, the SIS Act requires such an appointment where approved trustees do not have $5 million NTA in their own right.

The SIS Act specifies certain requirements for custodians of superannuation assets (sec. 123). The appointed custodian must be a body corporate (except for SMSFs) and must have at least $5 million NTA, or else have an 'approved' guarantee, so that the sum of the approved guarantee and the NTA is not less than $5 million. The disqualified person test also applies. It is the responsibility of the trustee to ensure that the requirements are met, but it is an offence under the SIS Act for a custodian to present itself as meeting the specified requirements when it does not.

The SIS Act does not regulate the operations of custodians. Instead, trustees need to satisfy themselves that the custodial arrangements they have in place to hold trust assets are safe, transparent and clearly understood. To assist trustees in this task, APRA has issued a circular setting out best practice benchmarks (box 4.4). Compliance with these best practice benchmarks is voluntary, except where the circular's 'requirements' are imposed through an approved trustee's instrument of approval issued by APRA (see section 4.1).

Box 4.4 **Custody requirements for APRA-supervised entities**

APRA Cross-Industry Circular No.1, issued in November 2000, provides guidance for APRA-supervised entities, which include superannuation entities and insurance companies, as to how these entities should fulfil their duties in respect of custody of assets. There are 14 requirements — 23 if the sub-requirements are counted. They include:

Requirement 1: assets to be held in Australia.

Requirement 2: custody contract to be executed in Australia.

Requirement 5: the non-cash assets of the superannuation fund should be kept separate and distinct from the Custodian's own assets.

Requirement 6: the trustee is expected to implement a demonstrable process to monitor and assess the custodian's performance on an on-going basis.

Requirement 7(1): the trustee is expected to undertake regular checks and seek information to satisfy itself as to its audited internal controls, organisational structure, staffing capabilities, administrative resources and arrangements for holding the fund assets.

Requirement 7(2): the trustee to satisfy itself as to the custodian's process of selecting, monitoring and reviewing its sub-custodians.

Requirement 7(3): the trustee to satisfy itself as to the financial strength of the Custodian and, where reliance is placed on insurance, satisfy itself as to the adequacy of that insurance.

Requirement 11(2): agreement to provide for custodian accepting liability.

Requirement 14: trustee board to sign off certification prior to using a custodian.

Source: APRA (2000).

In 2000, $142 billion of superannuation assets — about 25 per cent of the total — was placed with eight master custody service providers, three of which held 90 per cent of that total (table 4.2). Master custodians are typically large, well-capitalised, financial institutions with NTA substantially in excess of $5 million. All eight current master custodians are members of the Australian Custodial Services Association and conduct their affairs according to a Code of Conduct which includes security, reliability and standard of care provisions. Master custodians offer a range of additional services to superannuation funds beyond the basic custodial needs. These include investment performance analysis and monitoring compliance with asset limits specified in a fund's investment strategy.

Table 4.2 **Assets held under master custody arrangements[a]**
as at 30 September 2000

Custodian	*Total clients*	*Total assets*		*Superannuation assets*	
		$b	%	$b	%
Chase	33	76	22	65	46
National	46	123	35	35	25
Commonwealth	35	34	10	28	20
AMP Investment Administration	25	18	5	5	3
State Street	21	46	13	4	3
Perpetual	17	19	6	2	2
Permanent	24	13	4	2	2
BT Portfolio Services	28	20	6	1	1
Total[b]	**229**	**349**	**100**	**142**	**100**

a Statistics exclude assets of related parties. **b** Totals may not add due to rounding.

Source: InTech Financial Services (2001).

Although the entry requirements for custodians consist of three elements — the body corporate requirement, the disqualified persons test and the NTA requirement — the following assessment focuses on the $5 million NTA (or equivalent form) requirement, because it is the most likely to restrict entry.

Objective

The objective of the custodial requirements is to reduce the risks associated with the holding of fund members' assets. These risks include:

- operational failure of custodial accounting and record keeping systems — for example, computer systems failure — on a scale which requires resources additional to budgeted contingencies;
- institutional failure (commercial insolvency);
- poor or inefficient service, including not accurately recording holdings and mixing of custodian and client assets; and
- theft.

Reduction of these risks is important for the prudent management of superannuation entities. The requirement is for institutions which provide custodial services for superannuation assets to be sound. It also underlies APRA's set of 'best practice' benchmarks in custodial arrangements that are mandatory for approved trustees, but voluntary for other trustees.

Benefits

The $5 million NTA requirement on custodians is likely to reduce the risks of imprudent custody of fund members' assets. It will serve that purpose, in particular, when a trustee places custody of the assets with an entity which is not a large custodian with substantial financial resources. In such cases, if trustees follow the provisions in the cross-industry circular, the risks would appear to be adequately addressed (and the $5 million NTA could be somewhat redundant). If, however, the circular is not followed, the $5 million NTA assumes much more importance as it ensures that trustees engage custodians with $5 million NTA, which are more likely to provide safe and efficient custody, especially in the event of a problem arising. This is not to imply that there will necessarily be sufficient resources to deal with such cases or that a single amount is best for all cases. Rather, it is a somewhat arbitrary approach which increases the chances that some resources will be available.

Costs

The most likely costs of the NTA requirement are the cost of carrying additional capital and the possible exclusion of smaller custodians from the industry.

When the Government announced the $5 million NTA requirement for external custodians, it acknowledged there was a trade-off between the benefits of restricting entry of those which did not have 'substance' and the costs from 'erecting barriers to entry preventing access to the superannuation market for small, but competent, investment managers' seeking to be both the investment manager and custodian of the fund assets (Dawkins 1992, p. 21).[4]

The Commission has received no information to suggest that the $5 million NTA is excluding a significant number of small competitors or that significant fee reductions would be achieved if there were additional entrants. For example, there are 2081 securities dealers — another name for investment managers — presently licensed under the Corporations Law (the Managed Investments Act) and some are likely to have less than $5 million NTA. The Commission, however, did not receive representations from this or any similar group against the NTA for custodians.

It is not clear how many custodians have had to raise additional capital to meet the $5 million NTA requirement. The Commission notes, though, that a large

4 While investment managers were specifically identified as one group of potential custodians, they could come from a variety of backgrounds — such as accountants, non-superannuation trust companies, and real estate agents.

proportion of superannuation fund assets are held by large custodians which have capital resources far in excess of that amount.

In summary, the benefits of the $5 million NTA requirement for custodians of superannuation assets are likely to exceed the costs. Nonetheless, there is a need to consider whether the prudent management objectives could be met more cost-effectively.

Possible scope for improvement

The entry restriction on custodians, combined with the requirements on trustees to satisfy themselves about their custodial arrangements (set out in the APRA circular), is one approach for addressing the risks associated with custody of superannuation assets. ASFA argued that a more cost effective way of dealing with these risks would be for APRA (and ASIC) to supervise custodians directly:

> This process [of trustees being satisfied about custodial arrangements] has been seen by the superannuation funds as an onerous and costly requirement made necessary by the fact that neither APRA nor ASIC was able to directly regulate custodians. … Given that there are a handful of external organisations which provide custodian services and thousands of funds … direct supervision of custodians would be a more cost effective approach. … It would be administratively simpler and less costly for superannuation funds to be required to deal only with a licensed custodian, with the licensing system providing the necessary guarantees of the competence. (sub. 15, p. 15)

While the direct costs to trustees would decline if trustees did not have the responsibility to seek assurances from custodians, they may have to bear some of the costs indirectly (through cost recovery levies associated with licensing and monitoring of custodians). More importantly, such an arrangement would erode the fundamental basis of prudent management — namely, that the trustee is the sole responsible entity.

4.3 Approved auditors and actuaries

The SIS Act contains restrictions on who can conduct financial audits, compliance audits and certain actuarial functions. These are essentially in the form of professional qualifications, so that the tasks are undertaken by suitably qualified people, but have the effect of restricting entry.

In respect of each year of income, the financial statements and accounts of a superannuation entity must be audited by an 'approved auditor' who is required to give a report in the approved form to the trustee of the entity within the prescribed time (sec. 113 and reg. 8.03). In addition, the approved auditor must undertake a mandatory compliance audit of the entity (sec. 113(3)(b)). A compliance audit involves determining whether various provisions of the SIS Act and the SIS Regulations have been met (box 4.5).

Box 4.5 **Compliance audits**

Compliance audits involve testing compliance with a list of the SIS requirements identified by APRA. The current list, issued in 1998-99, contains about 31 sections of the SIS Act and 17 regulations. The list of provisions is changed periodically — for example, compared with 1997-98, two provisions were deleted and eight added.

Examples of provisions to be checked include:

Section 19(2), 19(3): the superannuation fund must have a trustee. The trustee must be a constitutional corporation pursuant to a requirement contained in the governing rules, or the governing rules must provide that the sole or primary purpose of the fund is the provision of old age pensions.

Section 36: the trustee must, within the prescribed period after each year of income, lodge an annual return.

Section 65: the trustee or an investment manager of a regulated superannuation fund must not lend money, or give any other financial assistance to a member or relative of a member.

Section 109: the trustee or investment manager must not invest money unless the trustee or investment manager and the other party are dealing with each other at arm's length.

Regulation 2.33(2): the trustee must provide information to members about significant events.

Source: APRA Circular IV.A.4.

To be an approved auditor (other than for SMSFs) a person must be:

- the Auditor-General of the Commonwealth, a State or Territory; or
- a registered auditor under the Corporations Law and have reached the specified status of membership of one of the specified professional bodies;[5] or

5 The five professional associations specified in schedule 1AAA (reg. 1.04(2)) are the Australian Society of Certified Practicing Accountants, The Institute of Chartered Accountants in Australia, the National Institute of Accountants; the Association of Taxation and management Accountants and the National Tax and Accountants Association Ltd. To be a superannuation auditor, a person needs to hold a certain level of membership (such as Member or Fellow) of one of these organisations. These level of memberships are generally 'higher' than the 'base' membership which is open to those holding certain tertiary qualifications. To be a Member generally involves completing an undergraduate degree and three years experience. For some bodies it also involves completing a professional 'program'. The next highest professional standard for most of the

- approved by the Regulator if, for example, a person's religious beliefs do not allow he or she to be members of a professional accounting organisation.

These requirements exclude those who are not registered auditors under the Corporations Law and also those who have not reached the required level of membership of a specified professional organisation.

An actuary, for the purposes of the SIS Act, is a person who is a Fellow or an Accredited Member of the Institute of Actuaries of Australia. The SIS legislation requires trustees to have certain calculations and reports prepared by an actuary including:

- actuarial valuations and funding and solvency certificates;
- certification of the level of 'special' in-house assets;
- certification of ability to return surplus to an employer sponsor;
- determination of pre-July 1988 funding credits.
- a program to return a technically insolvent fund to a solvent position; and
- a recommended alternative course of action for a fund that would otherwise need to be wound up due to the technical insolvency rules.

The need for these tasks in relation to accumulation funds is likely to be quite low.

A key role of auditors and actuaries is to notify the trustee if they believe that a contravention of the SIS Act may have occurred. The auditor or actuary need not inform the trustee if they honestly believe that the trustee has already been told of the matter. In addition, the auditor or actuary is required to give a written report to the regulator about the matter if the trustee fails to comply with the auditor's or actuary's request for a written report about the action that the trustee has taken or proposes to deal with the matter, or if the auditor or actuary is dissatisfied with the action taken by the trustee.

Similar notification obligations arise if the auditor or actuary forms the opinion that the financial position of the fund may be, or may be about to become, 'unsatisfactory' (as defined in reg. 9.04).

Objective

As indicated, the objective of restricting entry is to help ensure that those who perform important auditing and actuarial tasks have the necessary professional

bodies is a Fellow. This entails a much longer experience standard (such as 10 years) plus applicants must meet a 'seniority' or 'responsible position' criterion.

expertise and technical ability to complete the work competently. The audits and actuarial investigations are an essential external aid to the prudent management of superannuation funds. They provide fund members with independent certification that the trustees are carrying out their fiduciary duties in an appropriate manner and confirm the financial position of the fund. They also help with prudential supervision by informing APRA, where necessary, of possible problems in the operation of a fund.

Benefits

The benefits of the restrictions on who can conduct financial audits, compliance audits and certain actuarial functions come in the form of higher analytical and reporting standards and consequential improvements in prudent management. The restrictions are based on the view that the designated groups are best placed to undertake the tasks, whereas others, as a rule, are less able, and that the degree of difference is significant for the independent oversight of management of superannuation entities.

Costs

The Commission is not aware that the entry restrictions have restricted the pool of available auditors to such an extent that it has had a noticeable adverse affect on competition among superannuation auditors. For example, the Commission has received no complaints regarding high service fees or service availability because the pool of available superannuation auditors is too small. This is not surprising given the relatively large number of participants in the market. There are about 140 000 persons associated with the five professional accounting bodies identified in the SIS legislation. While not all meet the standard required by the SIS legislation for auditors of APRA-regulated superannuation entities, it would be expected that a sufficient number do.

In the case of actuaries, there are about 1235 Fellows and Accredited Members of the Institute of Actuaries of Australia, being those eligible to perform tasks specified in the SIS Act. About 17 per cent currently have their primary practice in superannuation matters, although all 1235 are free to bid for superannuation work. Further, if the number of defined benefit funds continues to decline, the amount of superannuation work may decline relative to the available pool of actuaries, thereby strengthening competitive forces.

In summary, the benefits of restricting the provision of financial auditing and actuarial services to superannuation funds are likely to exceed the costs.

Possible scope for improvement

Other suitably qualified people may be able to provide some of the auditing and actuarial services. For example, Finlaysons was of the opinion that lawyers may be capable of conducting compliance audits:

> Let me start off by saying that I actually have performed audit work myself, not as a solicitor but assisting an accounting firm doing audits. Because I'm not an accountant, I certainly didn't sign off on the audit, the partner did. So I do have experience in doing not only the compliance audits but the financial audit as well, and I believe that there would be very few areas of the compliance audit that are directly related to the financial audit. Significant amounts of compliance audit requires looking at member disclosure issues, looking at risk management statements. Just because risk management statements relate to an investment, it doesn't follow that that automatically relates to the financials of the fund.
>
> Certainly lawyers are trained in compliance areas. We certainly provide compliance advice, compliance manuals for our corporate clients in relation to the Corporations Law in relation to other pieces of legislation. There is no reason why SIS should be any different. (trans., p. 225)

Finlaysons considered that the confining of compliance audits to accountants was an 'accident of history':

> … in the first year of operation, SIS only required a financial audit, and didn't require a compliance audit. The approved [financial] auditor was a requirement there, and the approved auditor was an accountant, and the only requirement was a financial audit. By the time the compliance audit was introduced, I don't think anybody raised the issue of amending the definition to include the legal profession. I've never heard anybody raise it before. (trans., p. 225)

The skills and knowledge required to conduct a compliance audit include:

- financial accounting skills, to the extent that some of the variables involved in a compliance audit are financial;
- an ability to apply the concept of 'materiality'. An auditor is required to qualify the audit report for any breaches of the specified provisions which in his/her opinion are material;
- an understanding of the detailed provisions of the SIS legislation and APRA requirements; and
- testing of samples of transactions and making inferences about the entire population of transactions, as it is not possible to audit every transaction — for example, the SIS preservation requirements (reg. 6.17).

In the draft report, the Commission recommended that APRA, in conjunction with relevant parties, should review the need to confine the conduct and authorisation of a compliance audit to an approved financial auditor.

In response, William M Mercer (sub. DR51, p. 2) and the Institute of Actuaries of Australia (sub. DR55, p. 3) supported the view that other suitably qualified people should be permitted to conduct compliance audits. The Institute of Chartered Accountants in Australia, on the other hand, did not agree with the recommendation (trans., p. 323). Further, it observed that:

> … there are significant synergies between a compliance audit and a financial statement audit … for a number of the key operating areas … and it's just very efficient for the auditor to actually cover off both the compliance aspects and the financial statement aspects ... 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. (trans., pp. 319–20)

At present, auditors provide one report, covering both the financial and compliance audits. If non-accountants were permitted to have responsibility for compliance audits, there would be two separate reports.

The issue of skills and competence was raised by the Institute of Chartered Accountants in Australia. It said that it takes:

> … a number of years to become a seasoned auditor. … 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. (trans., p. 323)

However, it did not rule out the possibility that others, for example, lawyers, could acquire those skills:

> … 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. (trans., p. 324)

Separation of the audits would bring different perspectives to a fund's position and this could enhance prudent management. This may be important to the extent there have been some concerns raised about auditor independence (Ramsay 2001; SSCSFS 2001c).

As indicated, specific skills and competencies are required to undertake compliance audits. Entry restrictions are therefore justified. Approved financial auditors are not, however, uniquely, qualified to acquire them. Given the synergies between financial and compliance audits, the market for other suitably qualified persons could be limited.

In accordance with National Competition Policy principles, the Commission finds that the current SIS legislation may preclude suitably skilled people from being responsible for a compliance audit (in the future). This is because the legislation requires approved auditors to have a certain affiliation with specified professional accounting bodies, rather than being targeted more directly in terms of competence. To date, only those people affiliated in the specified manner are likely to have acquired the requisite skills — the Commission has not received any information to suggest there is a ready pool of sufficiently skilled people other than suitably qualified accountants. However, the legislation should leave open the possibility that other qualified people who are not affiliated with the scheduled accounting bodies may, at some time, be able to meet the standard required to sign compliance audits.

RECOMMENDATION 4.4

The Australian Prudential Regulation Authority, in conjunction with relevant parties, should review the need to confine the responsibility for a compliance audit to an approved financial auditor.

A second area where the SIS Act may exclude willing and capable participants is in relation to certain actuarial tasks for accumulation funds. William M Mercer commented:

> … that these [technical solvency] tasks could also be performed by many in the accounting/auditing professions. We point out however that the number of occurrences where actuarial involvement in an accumulation fund will be required is likely to be small. A properly managed fund should not become technically insolvent in the first place and few accumulation funds have surplus available to return to employers. (sub. 8, p. 5)

The costs of excluding, for example, accountants from performing these calculations is likely to be very minor, given the infrequency with which there may be a need for such calculations. Nonetheless, this does not obviate the need to remove the restriction on competition if such tasks can be performed capably by those who are not Members or Fellows of the Institute of Actuaries of Australia. The Institute of Actuaries of Australia said:

> The [draft report] recommendation … appears to relate solely to technical insolvency of accumulation funds, under Part 9 of the SIS Regulations. In this context, we agree with commentators who suggest that other professionals (such as qualified accountants with appropriate superannuation experience or qualifications) could carry out this task just as well as a qualified actuary. However, we would have considerable concern if it were advocated that actuarial tasks required under the SIS legislation could potentially be carried out by non-actuaries who do not have the required skills. (sub. DR55, p. 3)

RECOMMENDATION 4.5

The Australian Prudential Regulation Authority, in conjunction with relevant parties, should review the need to confine certain tasks in respect of accumulation funds to Members or Fellows of the Institute of Actuaries of Australia.

5 The SIS legislation: compliance cost concerns

According to participants, the compliance costs attributable to the SIS legislation are generally less than those attributable to other superannuation legislation such as the superannuation contributions surcharge. Nonetheless, there are several areas of the SIS legislation which impose significant compliance costs on superannuation entities that could be reduced by the use of more cost-effective alternatives. Of significance are certain requirements governing the operations of entities — specifically, limits on the acceptance of contributions and payment of benefits for persons according to their age and employment status, provisions protecting small account balances and lost members, provisions which require the preservation of non-residents' benefits, and requirements relating to risk management statements.

5.1 Introduction

Like all regulation, the SIS legislation imposes compliance costs. In some areas of the legislation, these costs may be significant and there may be scope to reduce them so that the objectives of the legislation are met in a more cost-effective manner. The following provisions of the SIS Act fall into that category:

- contributor status and payment standards;
- small and lost member account protection;
- non-resident benefits;
- risk management statements;
- lodgment of annual returns; and
- actuarial certificates.

The Commission's general approach to assessment of these matters is to outline the specific provision under review, clarify its objective, and provide an indication of the costs associated with meeting its requirements. Alternative means of achieving the objectives are then discussed.

A number of participants pointed to other provisions in the SIS Act which they considered did not meet its objective in a cost-effective manner. Examples include requirements governing key features statements and in-house asset rules. These provisions, however, are outside the scope of the Commission's inquiry and, accordingly, are not considered in this report.

The general nature of operating and compliance costs

Only very limited quantitative information is available with which to undertake an assessment of the magnitude of compliance costs that are imposed by the SIS Act. Most available information consists of anecdotal evidence provided by participants. Some quantitative information on overall administration costs is available from the Association of Superannuation Funds of Australia's (ASFA's) recent cost survey of 60 corporate, industry and public sector funds. This information was reviewed in chapter 2.

The available information suggests that the costs imposed on superannuation entities in complying with all relevant regulation — not just the SIS legislation — are not large. The ASFA cost survey showed that the 'administration costs' of superannuation funds are 'modest and falling on a per member basis' and that 'where administration costs came out of member benefits, the cost per member per week is low'. The ASFA cost survey also indicated that, overall, compliance costs were a relatively modest part of the total cost of administration. ASFA said:

> In 1999-00 the average administration cost per member for the funds surveyed was only around \$66 a year, around \$1.28 a week. This was down on the average of \$1.65 per member in the ASFA survey two years earlier. There was a decrease in average administration costs across the entire range of funds. The fall in costs was particularly marked for medium to large sized funds in terms of membership. (Clare and Connor 2001)

Although administration costs have been declining, this does not necessarily mean that the compliance costs associated with the SIS legislation have also been falling. The Institute of Actuaries of Australia noted that:

> In practice compliance costs have steadily increased in the last 15 years, but this has been offset by increasing administrative efficiency due to technological advances. In addition there has been an increase in the average size of funds (excluding self managed funds), as small corporate funds have closed partly due to rising compliance burdens.
>
> We believe that administration costs would have fallen much further, had it not been for increasing compliance costs. (sub. DR55, p. 2)

As noted in chapter 3, participants considered that the compliance costs attributable to the SIS legislation are less than those attributable to tax legislation such as the superannuation contributions surcharge. This appears to be confirmed by the ASFA cost survey, which showed that 23 per cent of respondents considered 'tax regulations and changes' and the 'new tax system (including the Goods and Services Tax)' to be the most important factors influencing changes in the administration costs of the funds responding to the survey (Connor 2001).

Nevertheless, although the costs of complying with provisions of the SIS legislation, and of coping with regulatory uncertainty, might not be as great as those involved with taxation legislation, it is important to consider whether there is scope to reduce these costs by improving the regulatory framework. Many participants consider that to be possible and that it would result in significant benefits to members. William M Mercer summarised this point by saying:

> The efficiency of superannuation funds (and hence their ability to compete against other types of financial product) could be improved significantly by simplification of the voluminous SIS Act, its associated Regulations, and Circulars issued by Regulators.
>
> Simplification and reduction of the requirements would also enable trustees to concentrate on far more vital issues such as maximising investment returns and the security of members' benefits. This would also enable the Regulators to concentrate on these vital issues rather than trying to ensure that trustees meet a large number of seemingly minor requirements. (sub. 8, p. 3)

As a broad indication of the magnitude of potential savings, a reduction of one per cent in administration costs is equivalent to some $25 million per annum. In addition to the cost of complying with the SIS legislation, there are also costs incurred by the regulator (and paid by the industry through levies) in performing its supervisory function. According to APRA, the costs of regulating the superannuation industry amounted to $24 million in 2000-01.[1]

5.2 Requirements governing operations of superannuation entities

Contributor status and payment standards

Provisions governing the circumstances in which superannuation contributions can be made and benefits must be paid involve similar compliance costs. Accordingly, these provisions are discussed together.

1 See APRA (2001e).

Contributor status

The SIS legislation contains a range of complex requirements which prescribe when a superannuation entity can accept a contribution for a person (regs. 1.03 and 7.04). In particular, prescribed age and employment restrictions limit the circumstances under which regulated superannuation funds can accept contributions. For example, for persons (that is, members or spouses of members) aged between 65 and 70, voluntary contributions can be accepted only if the person is gainfully employed for at least 10 hours a week. For persons aged above 70, voluntary contributions cannot be accepted. Examples of some of the complexities are given in table 5.1.

Table 5.1 **Contribution and payment standards in the SIS legislation**

Age	*Nature of contribution*	*Acceptance of contribution*	*Payment standard*
< 65	Superannuation Guarantee	No restriction	Benefit preserved till retirement
	Award	No restriction	
	Voluntary	*For self:* Member must have worked at least 10 hours in 1 week over last 2 years	
		For spouse: No employment test for member, or spouse aged under 65	
65 to 70	Superannuation Guarantee	No restriction	Benefit cashing compulsory unless member employed for at least 10 hours each week
	Award	No restriction	
	Voluntary	*For self:* Member must work at least 10 hours each week	
		For spouse: No member employment test. Spouse aged between 65 and 70 must work at least 10 hours each week	
70 +	Superannuation Guarantee	Not allowed under Superannuation Guarantee legislation	Benefit cashing compulsory unless member employed for at least 30 hours each week
	Award	No restriction	
	Voluntary	*For self:* Not allowed	
		For spouse: Not allowed if spouse over 70	

Sources: APRA circulars; ATO (2001c).

Objective

The underlying objective of the restrictions is to ensure that concessionally-taxed superannuation savings are used for retirement benefit purposes and, accordingly, to prevent abuse of taxation concessions. Limits on contributions for persons aged over 65, for example, guard against excessive use of the favourable taxation treatment of superannuation (for example, for wealth accumulation and estate planning purposes).

Costs

The different treatment of contributions based on a member's age and employment status in the SIS legislation creates complexities which bear on the costs of complying with that legislation. A number of participants expressed concern about the extent of these compliance costs and saw a need for simplification of the rules. Compliance costs arise, in particular, from the requirements for trustees to monitor and verify employment status for contributors over the age of 65 on a frequent basis.

Participants suggested that these costs are relatively large. This would appear to be the case particularly for industry and public offer funds where a large member base and the distant relationship between the trustee and member involve considerable costs in monitoring contributor status. Corporate funds, on the other hand, with generally smaller memberships and where the employer both accepts contributions from, and employs, the member, would typically face less significant compliance costs.

As an example of the nature and magnitude of the costs involved, the administration firm Jacques Martin Industry Funds Administration Pty Ltd (Jacques Martin) noted that it administers accounts for 21 000 members over the age of 65 and the employment status of these members is checked every six months. The total cost of this monitoring (including the mail out and additional labour costs) amounted to around $77 000 per annum.

Another example, based on a survey conducted by Investment and Financial Services Association in June 2000, showed that the combined cost for the eleven respondents of monitoring employment status for people aged over 65 was $131 000 per annum. Respondents also said that if they increased the monitoring frequency to a monthly basis (as suggested by APRA Circular I.A.1) the combined cost would rise to $1.7 million per annum.[2]

Costs are also imposed on members over 65 years of age in responding to trustees' monitoring requirements. These members need to take time to complete employment status documentation and, where applicable, they bear the cost of return mail. Costs also arise through the uncertainty created for employers, employees and trustees in understanding the different employment status requirements and, possibly, from distortions to workforce participation decisions (in order to comply with the requirements). The development and application of computer software to track and react to changes in employment status and age is also costly.

Participants raised a number of specific concerns regarding contributor status provisions. William M Mercer highlighted the complexity of the legislation in this area. It said:

> Complex rules affect when a fund can accept a contribution for a person. This is particularly the case for members over age 65.
>
> …
>
> The legislation … is not helped by APRA's interpretation of the 10 hour a week rule. In broad terms, a fund is supposed to check monthly whether the member is working 10 hours a week. Averaging of hours over a longer period is not allowed. This results in situations where a person can contribute in some weeks but not others. (sub. 8, p. 15)

Other participants raised similar concerns. The Institute of Actuaries of Australia said:

> One of the practical outworkings of the complexity of this aspect of the superannuation system is that both members and fund trustees are often confused about their entitlement to access moneys and to accrue ongoing benefits once they have reached age 65. Trustees are usually unable to effectively monitor members' employment status on an ongoing basis, and members often feel that attempts at monitoring are an unnecessary intrusion on their affairs. (sub. 16, p. 8)

ASFA also commented on the issue and said that 'the restrictions placed on contributions are complex, costly to administer and, one could argue, inconsistent and counter productive' (sub. 15, p. 12).

2 While APRA Circular I.A.1 states that trustees must have employment status checks in place such as 'monthly monitoring', the SIS regulations only specify that 'reasonable attempts' be made to keep informed about the member's employment status. The Commission also understands that most trustees, in fact, do not monitor on a monthly basis. Examples brought to the Commission's attention involved six-monthly monitoring.

There is also a more general point concerning an anomaly associated with the requirements. Unemployed persons, who are not permitted to make contributions, can have contributions made for them by their spouse who, if aged under 70, is not required to comply with the employment test (table 5.1). ASFA noted:

> There seems little logic in preventing a person contributing to a fund on their own behalf when they are unemployed, but yet permitting a contribution for that same person made by their spouse. The break in the link between paid employment, broken initially by the introduction of spouse contributions, will be further widened by proposed family law and superannuation legislation. (sub. 15, p. 12)

This is effectively a loophole created by the desire to 'encourage a greater level of superannuation contributions' (APRA Circular I.A.1, para. 45). It provides an opportunity for 'married' members to make superannuation contributions (on behalf of their spouse) when the same opportunity is not available to 'unmarried' members.[3]

Furthermore, the Institute of Actuaries of Australia noted also that the age limits specified in the SIS legislation had not been changed to take account of greater life expectancies (trans., p. 38).

Also commenting on the issue of life expectancy, PricewaterhouseCoopers said:

> At present there are a number of administrative rules in relation to funds accepting contributions from people aged 65 and above. We believe that with an ageing population and the smaller number of people still working at age 65, such rules could be relaxed. (sub. 14, p. 11)

With these demographic trends in mind, the compliance costs created by age-based employment status provisions would seem capable of improvement.

Payment standards

Payment standards within the SIS legislation cover a range of matters including cashing of benefits (both compulsory and voluntary), rollovers, transfers and preservation. The payment standards regulate the timing and payment of benefits provided by superannuation entities. Participants raised particular concerns about the requirement governing compulsory cashing of benefits.

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3 The definition of spouse does not require the couple to be legally married, but merely to be living together on a bona fide basis as husband and wife.

Compulsory cashing of benefits

Linked to the contributor status requirements are requirements that benefits in regulated superannuation funds (other than employer-financed benefits for members aged over 65) must be cashed, or rolled over for immediate cashing, as soon as practical after the occurrence of certain events (regs. 1.03 and 6.21). These events are:

- the member has reached age 65 but is less than 70 and is no longer gainfully employed for at least 10 hours each week;
- the member has reached age 70 and is no longer gainfully employed for at least 30 hours each week; or
- the member has died.

According to APRA Circular I.C.2, trustees are required (through arrangements such as monthly monitoring) to determine whether a member aged 65 or over is gainfully employed for a prescribed number of hours each week.[4] There is no scope to average the hours worked by a member over a longer period. If, after making reasonable efforts, the trustee cannot ascertain the member's ongoing employment status, compulsory cashing must occur.

Objective

Compulsory cashing-out, by regulating the timing of benefit payments, gives effect to the Government's retirement incomes policy. That is, it ensures that superannuation contributions are used for the bona fide provision of retirement incomes and not held in a concessionally-taxed environment for purposes other than retirement.

Costs

Participants pointed to the level of prescription and complexity involved with the payment standards as imposing significant compliance costs on superannuation funds. William M Mercer, for example, said:

> Complex provisions apply.
>
> For a person over age 70, the benefit in respect of pre age 65 accruals and any voluntary benefits accrued after 65 **must** be paid if the person works less than 30 hours in any one week. However, any benefit resulting from contributions made after 65

4 As in the example given in footnote 2, there may be a divergence between the requirements specified in the APRA Circular and industry practice.

> because of SG or award requirements does not have to be paid out if further such contributions are expected.
>
> For a person between ages 65 and 70, similar provisions apply except that the test is based on 10 hours a week rather than 30.
>
> These rules can result in situations where most of the benefit must be paid just because a person worked less than the usual number of hours in one week.
>
> Again APRA's view is that trustees should check at least monthly on employment status and that hours worked cannot be averaged over a longer period. (sub. 8, p.16)

Given that compulsory cashing provisions involve monitoring requirements identical to the contributor status provisions, the same types of compliance costs are involved — namely, the administrative and members' resources involved in tracking employment status.

The need for these detailed provisions, and the considerable costs of complying with them, was questioned by some participants in the light of existing safeguards in the SIS legislation. For example, the Small Independent Superannuation Funds Association (SISFA) pointed to the interaction between compulsory cashing and contributor status provisions which, it argued, meant that the latter provisions (and hence the requirement to monitor employment status) were unnecessary. It said:

> SISFA believes that the current compulsory cashing requirements that specify when a member must receive, or commence to receive, payment of monies held within the superannuation system negate any need for an upper age limit on the acceptance of contributions. (sub. 13, p. 9)

Participants' response to the draft report

In response to its assessment of the provisions governing contributor status and payment standards, the Commission recommended in its draft report that age and employment requirements governing contributor status and compulsory cashing of benefits should be simplified and that consideration should be given to treating members aged between 65 and 70 in the same manner as those under 65, provided there are no substantial implications for taxation revenue.

The general thrust of this recommendation received widespread support in submissions on the draft report. Indeed, many participants regarded simplification of these provisions as a principal means of reducing costs of compliance with the SIS Act. This could result in significant benefits for superannuation entities and their members. ASFA, for example, said:

> ASFA supports reform to this area of SIS. We believe, if properly done, such changes will address the compliance burden faced by many superannuation funds as well as meet the Community need for more flexible retirement arrangements. ASFA considers

the current rules relating to both contributions and the cashing of benefits for people who have reached preservation age are complex, inequitable, difficult to apply and not suitable for the modern workforce. (sub. DR56, p. 4)

Similarly William M Mercer commented:

We strongly support a simplification of the requirements. This would include similar treatment for those over 65 to that applicable to those under 65.

…

In our view, it would be far better to review the requirements so that there are no differences based on age. If any age barrier must be imposed, it:

- should not be before age 70;
- should apply both to the acceptance of contributions and the required payment of benefits; and
- should not depend on employment status.

Such an approach would be simple to understand and administer. All that would be required would be the member's date of birth. (sub. DR51, p. 2)

Industry Funds Forum concurred in commenting that:

The current provisions in this area are complex, inefficient and costly. The [Industry Funds Forum] believes there is substantial scope to reduce the compliance burden of relevant parts of the SIS legislation including by improving the current provisions relating to the employment test. We support the thrust of the Commission's recommendation. (sub. DR57, p. 3)

ASFA commented that the employment test did serve a revenue protection purpose and that allowing for the averaging of employment over an entire year would be an alternative to removing the employment test altogether (trans., p. 280).

Jacques Martin, on the other hand, pointed to other areas of the SIS legislation which would guard against the inappropriate use of taxation concessions in the event that age and employment provisions were relaxed. It said:

Developments in this area, including the refinement of the Reasonable Benefit Limits (“RBL”s), especially with respect to death benefits; the abolition of the “averaging method” for maximum deductible limits and, in particular, the introduction of the surcharge, have reduced the tax effectiveness of superannuation. This in turn has reduced the potential scope for “rorting” the tax concessions afforded to superannuation.

If there is a concern that there is potential for persons to contribute excessive amounts of voluntary, member undeducted contributions, perhaps consideration could be given to either imposing a maximum amount per person per year or developing a form of RBL measurement to account for undeducted contributions.

…

> We would suggest that, given the existence of RBLs, age-based maximum deductible limits and the surcharge (subject to the qualification with respect to undeducted contributions discussed previously) consideration should be given to: -
>
> - allowing all contributions until age 65, irrespective of employment status;
> - allowing contributions between ages 65 and 70 provided employer contributions are being made;
> - allowing mandated contributions only after age 70; and
> - deferring compulsory cashing of benefits until employer contributions have ceased. (sub. DR62, pp. 10–11)

Assessment

Contributor status and benefit cashing provisions serve an important purpose in ensuring that concessionally-taxed superannuation savings are used solely for retirement benefit purposes. Current age limits and the associated requirements of the legislation, however, appear to impose significant compliance costs on many funds, raising their administration costs, as well as on their members. The present requirements do not seem to pay adequate attention to a number of relevant matters.

These include increases in life expectancy and labour force participation for persons aged over 65; the compliance costs associated with frequent monitoring of employment status; the general weakening of the original employment nexus as a result of the introduction of eligible spouse contributions and family law amendments; and the existence of other legislative provisions which prevent excessive use of tax concessions (such as reasonable benefit limits and age-based maximum deductable limits).

Changes to this area of the SIS legislation would result in significant compliance cost savings to superannuation entities and benefits for their members. Treating members aged between 65 and 70 in the same way as those under 65 would result in virtually the same benefits (and involve the same risks to revenue) as removing the employment tests completely, given that the employment tests for the former group are not burdensome. This would suggest that the age for compulsory cashing of benefits should be raised.

The Commission considers that removal of the employment tests which govern contributions and benefit payments is justified provided that the risks posed to taxation revenue can be dealt with effectively. As noted above, some existing arrangements (such as reasonable benefit limits, age-based maximum deductible limits and compulsory cashing provisions) operate to reduce such risks.

Removal of the employment tests would also negate the need for responsibility being placed on members to verify their employment status — a part of the Commission's draft recommendation which received a mixed response. Jacques Martin (trans., p. 356) supported the recommendation while William M Mercer (sub. DR51, p. 2) opposed it.

As a result of these changes, voluntary contributions up to the new compulsory cashing age would be allowed regardless of a contributor's employment status. On reaching that age, accumulated voluntary contributions and their earnings would be required to be compulsorily cashed.

RECOMMENDATION 5.1

Age and employment requirements governing contributor status and compulsory cashing of benefits should be simplified. The most effective means of doing so would be removal of the employment tests, while limiting any adverse implications for taxation revenue by measures such as reasonable benefit limits and age-based deductible limits. Consideration should also be given to raising the age at which benefits must be compulsorily cashed.

Benefit protection

Standards relating to the protection of member benefits, protect small account balances and lost member accounts from erosion by administration costs.

Small account balances

In relation to small account balances, trustees are required to protect members who have withdrawal benefits that are less than $1000 and whose balances contain, or have contained, the Superannuation Guarantee (SG) or award-related contributions (regs. 1.03, 2.19 and 5.17). This protection can be provided in one of two ways. Trustees can choose, at the end of a member reporting period, to protect the member's balance within their own funds. If a trustee does not do that, it must roll-over or transfer members to an entity which provides member protection, such as an Eligible Rollover Fund (ERF). A member's balance must also be protected upon exit from the fund.

Lost member accounts

Lost member accounts must be protected, regardless of the account balance (regs. 1.03A, 5.17 and 11.08). According to APRA Circular I.B.1, members are considered to be 'lost' if, at a particular time, they are uncontactable, inactive (for two years) and the trustee has not verified their address or their benefits have been rolled over or transferred into another fund as a lost member. A member is uncontactable if the fund has never had an address for the member; or the fund has attempted to contact the member at the member's last known address on two occasions in writing without success; or one communication has been attempted and the trustee is satisfied that a second will not be successful.

All superannuation entities are required to notify the ATO on a half-yearly basis of their lost member accounts. The ATO then consolidates this information into its Lost Members Register. As with small accounts, trustees may transfer lost member accounts into an ERF. Trustees are required to advise members on joining the fund of their policy with respect to transferring members to an ERF, the circumstances in which it is likely to occur (including becoming lost) and disclose the name and contact details of the ERF they have selected to use.

Currently, there are approximately 4 million accounts on the Lost Members Register (representing around 18 per cent of total superannuation accounts) containing assets of around $5.5 billion. This represents an average of close to $1400 per account. Of relevance to the discussion below, lost member accounts with balances above $1000 number around 1 million and contain assets of $4.9 billion (an average of $4900 per account). The 3 million accounts with balances below $1000 have an average balance of around $200.

Objective

The objective of the standards is the protection of fund members' benefits. This is achieved by preventing the erosion of small and lost member accounts which would occur as a result of administration charges exceeding investment returns in any given period. These standards are based on the view that the erosion of small or lost member accounts through administration charges is unreasonable from a community-wide perspective. The financial benefits of the standards accrue to the holders of these small or lost member accounts.

Costs

The small account balance and lost member protection provisions were raised by some participants as relatively complex requirements which impose detailed obligations on trustees and administrators. The provisions appear to require detailed assessment and decision making processes, which could be costly. Participants sought a review of these provisions with a view to simplifying or streamlining them and reducing administration and compliance costs.

Because the costs of administering small accounts balances are not borne fully by their owners, other members bear (slightly) higher administration charges. In addition to this cost shifting, administration of member protection standards involves slightly higher costs associated with the need for customised treatment of small accounts which differs from that of accounts with balances in excess of $1000. PricewaterhouseCoopers said:

> In hindsight, we believe this legislation has produced inequities in the system and therefore is anti-competitive. Members with higher account balances are paying for the administration costs of smaller account balance members. … We also believe the administrative costs of complying with the member benefit protection … are significant and cause inequities between members. (sub. 14, p. 12)

Nonetheless, costs can be reduced by trustees making use of existing legislative provisions which enable them to transfer small accounts into an ERF. ERFs have the lowest cost structure of all superannuation fund types (although their capital-guaranteed nature means that, over the longer term, they provide lower returns).

In terms of lost member accounts, the costs are likely to be greater (than for small accounts) because of the administrative procedures required to be followed in attempting to contact lost members.

Jacques Martin (which administers 350 000 lost member accounts) pointed to inadequacies with the lost member definition in the SIS legislation and the process of verification, both of which created additional costs. It mentioned that where members had been inactive for two years, they are assumed to be lost, and in order to find the member an address verification requirement is activated. Where contact is unsuccessful, the fund must pass on the member's details to the ATO, which may then write to the member. Jacques Martin considered that this can cause considerable annoyance among those members, who cannot understand why the fund has reported them as lost when they are still in receipt of communication material from the fund.

As such, many members who are considered to be 'technically lost', are in fact well aware of where their superannuation was located. This would suggest that the figure reported above for the number of lost member accounts is, in fact, an overstatement.

Jacques Martin also commented on what it saw as two anomalies associated with the lost member provisions. As one example, it referred to the inconsistency between specifying a two year account inactivity period with respect to superannuation (a long-term investment) and legislation on lost bank accounts which specified six to seven year inactivity periods. As another, it drew attention to the unintended potential for preferential treatment to be accorded to lost members.

On this point Jacques Martin said:

> So you've got your twin members in the account, one of whom has moved and not told us their new address. I'm the other one, who was diligent and did, and then the two of them are sitting there starting at $1100 because the returns are zero. The one who told us the new address pays their $52 worth of fees and the one who forgot to tell us their new address but is probably still having employer contributions made and knows perfectly well where the money is, suddenly is protected [from administration costs]. (trans., p. 359)

A recent initiative announced by the ATO may help to reduce the costs of tracking lost members. The ATO has made its new 'SuperMatch' system available to superannuation funds to enable them to reunite lost members and their accounts. The system provides electronic access to data in the ATO's Lost Member Register. Details of potential matches are provided to relevant funds, which notify members and assist them to transfer the money to an active superannuation account (CCH Australia 2001b, p. 28). Indications from the ATO are that this initiative is proving to be quite successful.

Participants' response to the draft report

The draft report invited participants to provide information on the extent of use of roll-over provisions in order to reduce compliance costs associated with administration of small balances and lost members. They were also asked for information on other means of reducing these costs. In response to this request, Jacques Martin drew attention to the limits on using ERF's in order to achieve this aim:

> Trustees use the roll-over to an ERF provisions fairly extensively to reduce the incidence of the number of **small and inactive** member accounts requiring protection, and accordingly minimising the cost impact upon the fund. It should be noted, however, that this is not in the way of reducing the costs of creating a regime which ensures compliance with the legislation.
>
> Where an account is **small but is still active** (ie contributions are being received into it) then the option of rolling-over the account to an ERF is not available to the trustee. This can occur either when it is relatively early in the period of fund membership, or when the level of contributions being made is small or the amount in the member's account is being reduced significantly by insurance premiums.
>
> When a member's account is **active but the member is lost,** because while the account is in receipt of employer contributions, mail has been returned, then again the trustee does not have the option to roll-over the account into an ERF.
>
> If the member is **two year inactive but the account balance is over $1000** then generally the trustee will not roll-over the account to an ERF as it would normally be self sufficient except in years of extremely low or negative returns. (sub. DR62, pp. 14–15)

As alternative means of reducing these costs, it said:

> Two possible means of reducing these costs would be: -
>
> - to no longer require the protection of lost member accounts in excess of $1,000; and
> - given the long-term nature of superannuation and the existence of preservation, to increase the period of inactivity from two years to say seven. (sub. DR62, p. 15)

Assessment

The financial benefits that accrue to small account members from benefit protection standards are offset by the additional administrative charges borne by other members. There is, therefore, no net gain to the community from their application. Benefit protection standards also impose additional compliance costs in the form of customised account maintenance requirements for some superannuation funds and administrators.

Legislative provisions allowing the transfer of small accounts to low cost ERFs provide some scope for superannuation funds to reduce these compliance costs (although there are limits). It may also be the case that small account balances remain in this category because their owners have a number of accounts and there is limited scope for account consolidation. In that event, industry attempts to enhance portability should help to reduce the extent of the small account balance problem.

For lost member accounts, administrative procedures involved in attempting to contact account owners result in additional compliance costs. Given the large number of lost members, there is a question as to whether the current requirements for identifying such members are satisfactory. As trustees are required to inform members of their policy with respect to transferring such accounts and the contact details of the ERF where the funds are to be held, this raises the question of why the onus of responsibility for maintaining contact with a member's account should not rest with the member.

Moreover, for lost members with account balances above $1000, the provisions simply serve to protect these members from administration costs in times of low investment returns, and often because a member may be technically classified as lost (when in fact they are not). This can place such members in a more favourable position than members with equivalent account balances who are not 'lost'. As mentioned above, there are around 1 million lost member accounts in this category, with an average account balance of close to $5000. These members should bear the full costs of administration for their accounts.

The Commission considers that removal of the current requirement for trustees to verify the addresses of all lost members would result in substantial compliance cost savings for superannuation funds. To assist in ensuring that lost member accounts are available to be reunited with their owners, other legislative provisions covering lost members, currently in place, should be maintained. For example, funds would still be required to notify the ATO on a half-yearly basis of their lost member accounts once the current criteria (other than address verification) for lost member status are met. Also, trustees would continue to be prohibited from distributing the balances of lost member accounts to other members of the superannuation fund.

FINDING 5.1

Protection of small account balances is warranted.

RECOMMENDATION 5.2

The present requirement on trustees to verify the addresses of all lost members should be removed. Protection of lost member accounts with balances in excess of $1000 should also be removed.

Non-resident benefits

An issue associated with preservation requirements, but more specific to portability, involves the treatment of benefits for overseas residents working in Australia for a short period of time (for example, tourists on a working holiday and professionals on short-term employment contracts). Employers are required to make SG contributions for these employees, which are preserved in a complying Australian superannuation fund. Non-residents may also make voluntary contributions or have award contributions made on their behalf by employers.

There appear to be two reasons for requiring SG contributions for non-resident employees. First, a single uniform requirement that all employees be subject to SG provisions is simpler than having different rules for different categories of employees, which may prove complex to administer (for example, requiring identification of a bona fide non-resident short-term employee). Second, failure to impose SG provisions on non-resident short-term employees might create a bias in the labour market as employers switch away (where possible) from higher cost (due to the SG) domestic labour.

Objective

The provisions serve to protect government revenue by guarding against the potential for some individuals to gain access to their concessionally-taxed superannuation benefits before reaching preservation age. For example, a non-resident employee, who eventually seeks residence in Australia, could gain access to his/her superannuation benefits on the pretence of leaving Australia permanently.

Costs

The application of preservation standards for short-term (or in fact any) non-resident employees leaving Australia permanently can mean that a typically small preserved benefit will remain in a superannuation entity for what could be a very long time. In these cases, the administrative and compliance costs associated with managing small account balances and lost member accounts discussed earlier are likely to be even greater because the member resides overseas.

PricewaterhouseCoopers noted that:

> Workshop participants … believed the costs of administering rules in relation to overseas visitors working in Australia were both costly to comply with and provided very little benefit as once these visitors leave Australia, any benefits are quite often lost through either the member not keeping overseas address details up to date or the balance becoming too small for the member to worry about. The rules in relation to accepting such mandated contributions should be removed for people working in Australia temporarily or alternatively amounts should be paid out when the visitor leaves Australia. (sub. 14, p. 11)

Both SISFA and William M Mercer suggested that the Government has a secondary aim in maintaining this arrangement. SISFA said:

> There is inconsistency in the portability of benefits as between Australian superannuation funds and their overseas counterparts. At present, regulated superannuation funds in Australia are permitted to accept transfers of benefits from foreign pension schemes or similar vehicles, but **not** vice versa.
>
> The Government has indicated its favour for “bilateral negotiations with other countries to facilitate reciprocal agreements for the transfer of superannuation benefits by non-residents on permanent departure from Australia” … We endorse this approach, but seek a firmer commitment from the Government to commence the process and address this portability issue. (sub. 13, p. 3)

William M Mercer concurred:

> The Government has argued that it wants to use this as a bargaining chip in negotiations with other countries in order to obtain reciprocal rights. We note that many employees from overseas come from the UK and New Zealand. Both of these countries have allowed superannuation benefits to be transferred to Australia in similar circumstances for many years yet Australia is not prepared to reciprocate. This position often results in Australians effectively subsidising the administrative costs of maintaining a relatively small benefit for a member who is unlikely to ever return to Australia. (sub. 8, p. 17)

Participants' response to the draft report

In the draft report, the Commission recommended that restrictions on access to superannuation benefits by bona fide non-resident employees should be simplified and that benefits not exceeding a specified small limit could be allowed to be repatriated. While participants were supportive of the need to simplify the provisions, there were differences among participants in terms of the detail as to how to simplify the provisions and thus reduce compliance costs. This also served to highlight the disparate impacts of the provisions on different categories of non-residents. Focussing on high income individuals, William M Mercer said:

> Whilst we agree with the thrust of the recommendation in the draft report, we are concerned that if a limit is imposed, the chosen limit may be too small to be effective. We would suggest that the limit be no less than $20 000. Even this limit would create problems. For example, an overseas employee temporarily working in Australia on a 3 year secondment earning $100 000 pa would exceed this limit with only superannuation guarantee contributions.
>
> As an alternative, we consider that transfer of benefits of any size be allowed provided that the transfer is made to a bona fide superannuation fund in the member's new country of residence or home country.
>
> We also note that these problems would be reduced if employers were not required to make Superannuation Guarantee contributions in respect of employees who continue to be entitled to ongoing employer contributions to a superannuation fund in their "home" country. (sub. DR51, p. 3)

William M Mercer also questioned the extent to which non-resident benefits were concessionally taxed for individuals on higher salaries:

> Can I just comment on the tax advantages there? I'm assuming we're talking about a fairly highly paid individual. Any contributions made to that fund by the employer would be subject to 15 per cent contribution tax. In addition to that, it's likely that there would be a 15 per cent surcharge. So we've already paid 30 per cent tax on the contributions on the way in. If that person were to take the money out of the fund, say on returning to their home country, assuming the person was under 55 at that point of time which would be the norm, again there's another 21 and a half per cent tax on the benefit, assuming he hasn't gone over the reasonable benefit limit, in which case it would be, say, 48 and a half per cent. There's really not much of a tax advantage left. (trans., p. 418)

ASFA advocated exempting from the SG foreign nationals who worked in Australia and were being paid by their home country employer. In this case, it was argued, employers were effectively paying superannuation twice. In terms of foreign nationals on working holidays in Australia, on the other hand, ASFA said:

> ASFA has always accepted that foreign nationals on working holidays in Australia should be subject to the Superannuation Guarantee. However ASFA also believes that these people, on permanent departure from Australia, should be able to remove their

superannuation from the system. While ever the ongoing maintenance cost of these usually small accounts is an impost on the earnings of all fund members, the retention of the money in the superannuation system cannot be justified in terms of a retirement income policy for Australians. (sub. DR56, pp. 5–6)

Assessment

The preservation of small account balances for bona fide non-resident employees involves compliance costs similar to (if not greater than) those for small and lost member accounts. There is scope to reduce these costs — for example, by allowing these benefits to be cashed out on permanent departure from Australia. The risks posed to taxation revenue could be reduced through the imposition of a taxation adjustment on these accounts to offset Australian tax concessions.

However, in the case of small accounts, the cost of applying an adjustment could exceed its benefits. This suggests that consideration could be given to allowing bona fide non-resident employees with small superannuation account balances to repatriate superannuation benefits from Australia free of any taxation liability. Application of a small limit to such repatriation would probably cover the majority of non-residents in this category — namely, those on working holidays. In order to ensure that the provisions are not used to take advantage of available tax concessions, for non-residents with superannuation account benefits above that limit, the withdrawal of benefits should be subject to a taxation adjustment.

The issue of exempting from SG those non-residents for whom their 'home country' employer makes superannuation contributions raises issues which are beyond the Commission's terms of reference. The Commission notes that the number of individuals that fall into this category is also likely to be small, and that it is unlikely to lead to substantial compliance costs for Australian superannuation entities.

RECOMMENDATION 5.3

Superannuation benefits of bona fide non-resident employees below a specified small limit should be available to non-residents on permanent departure from Australia. Amounts above that limit should be subject to a taxation adjustment to offset Australian tax concessions accorded to superannuation.

Risk management statements

The SIS legislation specifies that, where a charge is created by the use of a derivative (defined as financial contracts whose value is based on some underlying asset, liability or index), the trustee must prepare a risk management statement (RMS) and report to members if the value of assets subject to a derivatives charge exceeds 5 per cent of the fund's total assets. The RMS sets out the procedures in place covering the use of derivatives, controls on their use and the processes for ensuring compliance with those controls.

Objective

The underlying rationale for placing limits on the use of derivatives is the prudent management of superannuation funds. Use of derivatives is allowed in order to manage risk exposure, but not for outright speculative purposes. The RMS supports this objective by providing documentary evidence that the level of derivative risk adopted by an entity is consistent with the best interests of the beneficiaries.

Costs

Several participants raised concerns regarding RMS provisions. Particular concerns related to the prescriptiveness of the provisions, their associated complexity and, as a consequence, the costs involved with compliance. Examples of these concerns included those from the Institute of Chartered Accountants in Australia which questioned the extent to which the RMS was achieving its objective with respect to trustees:

> … for the vast majority of super funds, the risk management statements are really not communicating clearly the risks and the processes involved. They tend to be quite technical and very difficult to get your mind around. … they tend to be very lengthy documents. I think a lot of trustees are just going through the motions of collecting all this information, but really not in a strong position to evaluate and challenge what is coming through. … there needs to be more emphasis on the reporting of derivative exposures to the trustees in a format that they can understand and in a format that they can monitor as opposed to presenting them with a whole framework of how do we manage the derivatives internally. (trans., p. 27)

PricewaterhouseCoopers commented on the duplication created in certain circumstances by RMS compliance audits:

> … where a fund outsources its investment management and it has a number of investment managers, each of those investment managers is required to have a risk management statement and that risk management statement is required to be audited. … the risk management statements are basically the same; the investment manager has one risk management statement which it uses for each of the funds that invest in that investment manager. So there is a degree of duplication in that every single fund is looking at the same risk management statement which has been audited. So is there the potential to place some reliance on the audit that has already occurred? (trans., pp. 136–7)

At a broader level, ASFA cited the RMS as one example of changes to the SIS legislation leading to creeping prescriptiveness and complexity (sub. 15, p. 11).

Participants' response to the draft report

In the draft report, the Commission recommended that the content of the RMS should be simplified in order to reduce compliance costs and to sharpen the prudent management focus of trustees. Those participants who commented on the recommendation were supportive of it. William M Mercer said:

> We are in general agreement with the proposals to simplify and review the requirements for Risk Management Statements. The current system is inefficient and concentrates too heavily on derivatives.
>
> As an example, we are aware of a situation where a fund had to engage an auditor to audit a trustee declaration that it did not need a Part B RMS (because the fund did not invest directly in derivatives).
>
> We consider that the best approach would be for the requirements to be revised by a group of industry representatives working with APRA. ASIC could also be involved due to its role with unit trusts which are used by many superannuation funds. …
>
> Issues to be considered should include:
>
> - The content of the RMS
> - How it links with Investment Policy Statements
> - Who should be required to prepare an RMS (the trustee, the investment manager or both)
> - How should the system be monitored (eg should there be a form of compliance audit by a licensed investment adviser?)
> - How can trustees be given greater comfort of an investment manager's risk management procedures? (sub. DR51, pp. 3–4)

ASFA concurred and mentioned that APRA was intending to review the current requirements. It said:

> The draft report recommends simplification of the Risk Management Statement (RMS) for Derivatives. ASFA supports changes that would reduce associated compliance costs for superannuation funds. The view of many in the industry is that the RMS requirements initially focussed trustee attention on derivative investments, in the wake of the Baring's collapse. However, the RMS requirements are now seen by many as costly and burdensome, with modest benefit for trustees.
>
> It has come to our recent attention that APRA intends to review the current RMS requirements set down in Superannuation Circular H.D.7. ASFA intends to cooperate with this review.
>
> …

> ASFA will work with the regulator to improve the effectiveness and relevance of Risk Management Statements. (sub. DR56, p. 6)

Assessment

The requirement to monitor and control the use of derivatives in a fund's investment strategy (and the preparation of an RMS to assist in this aim) is justified on the ground of enhancing prudent management. Current requirements for complying with RMS provisions, however, do appear to involve unnecessary costs which could be lessened by reducing the extent of prescription involved in the regulation and removing the duplication involved in RMS compliance audits.

The benefits derived from RMSs may also be greater if they were simpler and provided greater assistance for trustees in understanding the risks associated with use of derivatives. Prudent management might also be improved by encouraging funds to focus on the risks of particular investment strategies rather than on mechanistic reporting requirements.

RECOMMENDATION 5.4

Requirements governing the content of risk management statements related to investment in derivatives should be simplified in order to reduce compliance costs and to sharpen the prudent management focus of trustees. The present requirement that such statements be prepared by both investment managers and trustees for compliance audit purposes should be reviewed in order to remove any unnecessary duplication.

5.3 APRA reporting requirements

Lodgment of annual returns

It is compulsory for every superannuation entity regulated by APRA to lodge an annual return with it (sec. 36). The return must be lodged with a trustee certificate and an audit report signed and certified as a true copy by the trustee. Apart from details regarding the fund, trustees and other providers, such as external investment managers, service providers, custodians and auditors (where these are relevant), the return seeks data on a range of matters. This may include fund income and expenditure, fund assets and liabilities, and compliance and prudential details.

In July 1998, the Government announced that it would adopt a common reporting timeframe for all prudentially regulated superannuation entities, requiring annual returns to be lodged within four months of completion of the financial year (reg. 11.02). Previously, only public offer funds had been required to report within four months. Small APRA funds had to report within nine months and all other APRA-regulated funds within six months. This reduced reporting period was to apply to funds with a year of income that ended on or after 30 June 2000. Where a return cannot be lodged within four months, a late lodgment fee may apply. Funds may request an extension of time to lodge their annual return in extenuating circumstances.

In 1999-2000 (the first year of application), only 17 per cent of annual returns were lodged within the four-month reporting period. According to APRA, an information campaign conducted in the following year led to a substantial improvement in compliance, with 71 per cent of annual returns being submitted on time.

Objective

The main purpose of annual returns is to provide information to assist APRA in its supervision of superannuation entities and the industry generally. In particular, the returns are used to establish a database that APRA can use to evaluate the financial risks associated with the various entities. A shorter period for lodgment of returns means that APRA obtains this information in a more timely fashion and should be in a better position to discharge its duties more effectively. APRA has indicated that:

> APRA's risk-based approach to supervision involves regular off-site surveillance to identify high-risk entities for more intensive on-site reviews. Review of returns is a crucial part of the off-site surveillance process and its usefulness hinges on the timeliness and accuracy of the data provided in the returns. … Superannuation returns are required only annually while most other APRA supervised entities report quarterly. The reduced frequency makes it difficult for APRA to detect deteriorations and institute preventative actions. A long lodgment period will aggravate the problem. (sub 49, part 1, p. 5)

APRA has also said:

> … improved data returns and collection techniques, currently being developed, will lead to a significant improvement over time in the quality and detail of information provided by superannuation funds. A regular flow of such data is an integral part of building risk profiles of individual institutions which, in turn, is critical to a risk-based approach to allocating supervisory resources. (sub. 36, pp. 10–11)

This, in turn, should produce benefits for fund members by reducing the likelihood of imprudent management of their contributions by trustees.

Submission of annual returns as soon as possible after the end of the financial year also imposes an important discipline on trustees to have both the financial accounts and compliance verification processes completed and audited. These processes provide essential information to trustees and to fund members about the financial and general condition of the fund. They are also one indication of the ability of the trustee to manage the fund efficiently.

Costs

There are compliance costs in submitting annual returns, but these are generally accepted as necessary. The shorter reporting deadline, however, compresses the reporting workload. This increases the compliance costs faced by those (mainly trustee corporations) which prepare these returns for superannuation funds.

It was submitted to the Commission that the tighter reporting date might even make it impracticable in some cases to obtain the necessary details for some managed investments. For example, some superannuation entities may have invested in managed investments and unit trusts that are themselves subject to delays in reporting to investors. This situation is compounded by the fact that a growing proportion of assets in managed funds and retail superannuation products are invested offshore (for example, in international equity markets).

This may even lead to a bias in investment decisions with a forgoing of investments in certain asset classes (such as property and unlisted investment trusts) or regions as a consequence of the difficulty in obtaining timely information to complete the annual return.

The costs of acquiring such information may be greater within the reduced timeframes for some superannuation entities such as small APRA funds that previously had a longer period within which to report and are more reliant on the information and support services provided by other organisations. Where the information is not physically available within the statutory reporting period, estimates would have to be made, potentially reducing the accuracy of information received and raising the chance of error in statistical analysis of results by APRA.

A number of participants commented unfavourably on the reduction in the reporting period to four months for lodgment of annual returns for some superannuation entities, particularly small APRA funds. Their concerns relate to the resulting increased costs and likely deterioration in the quality of returns. Several large accounting firms have made representations to this effect to the Minister for Financial Services and Regulation. SISFA said:

> For funds other than self managed superannuation funds, we consider that the time for lodgment of annual reports required under the SIS Act must be reviewed. … Our experience suggests that this requirement is often a physical impossibility, given the number of outside parties who must be relied upon by the trustees of a fund to meet their financial reporting and audit obligations. (sub. 13, p. 2)

William M Mercer expressed similar views and referred to the longer-term impact on costs resulting from the peak workload for those involved in the administration, accounting, and auditing of funds in the four months following the end of the financial year. It indicated that it would either be required to overstaff for the remainder of the year or employ temporary, but often inexperienced, staff (sub. 8, p. 14).

The Trustee Corporations Association of Australia also commented that the reduced period for preparation of returns by small APRA funds is impossible to achieve and that the appropriate period should be nine months. (This is the period allowed for small self-managed superannuation funds.) The Association considered that 'this is appropriate given the longer time frames required to collect information from the broad range of investments undertaken'. It went on to say that it doubted that 'any responsible audit firm could audit the thousands of returns within four months' (sub. 26, p. 3).

Similar sentiments were expressed by the Institute of Chartered Accountants in Australia and Tower Trust. The latter is an approved trustee for more than 4600 small APRA funds (out of a total of just over 8000 such funds at June 2001). Tower Trust indicated that many small APRA funds 'now face the prospect of a $550 late lodgment penalty' (sub. 20, p. 3).

In response to the criticisms outlined above, APRA said:

> APRA does not accept the argument that a shorter lodgment period would reduce the thoroughness of the audit and the quality of returns. We believe that a substantial amount of the audit work should be undertaken during the year rather than at the end of the financial year. If a shorter lodgment period forces auditors to plan in advance and spread compliance work throughout the year, this would be a good outcome. (sub 49, part 1, p. 5)

APRA also pointed out that the four-month lodgment period is consistent with the requirement for public offer superannuation funds as well as for other APRA regulated institutions.

Participants' response to the draft report

In the draft report, the Commission found there was good reason to continue with the four-month lodgment period (with comment sought on whether small APRA funds should be given more time) and invited participants to provide quantitative information on the costs of complying with it.

Subsequent submissions, however, continued to question strongly the appropriateness of the four-month lodgment period for all types of APRA-regulated superannuation funds. Common themes which emerged from these submissions again included the substantial costs involved in meeting the deadline, the length of time service providers (such as investment managers and administrators) needed to provide the necessary financial information to trustees and for it to be audited, the coincidence of the reporting timeframe with other legislative requirements (such as the superannuation surcharge), the need for a 30 June year-end, the inability of small APRA funds to perform audit work throughout the year (as suggested by APRA) and the requirement's effectiveness in alerting APRA to potential problems.

The Institute of Chartered Accountants in Australia recounted in detail the difficulties faced by the industry in meeting the deadline. It stated:

> The problems faced by funds when meeting these deadlines have been reported to the Minister for Financial Services and APRA and are as follows:
>
> - Logistical and resource demands, including the inability of administrators to obtain quality temporary personnel (with a four month period prescribed period they will be competing for quality resources with corporate fund administrators);
> - The inability of systems to have all the required accounting and investment information available in time to allow the preparation of accurate statutory reporting;
> - 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 and/or available for external sources to allow for reporting within the reduced time. This will necessitate a greater use of estimates, which may lead to inaccuracies when compared to the final investment valuations;
> - The current form of the APRA annual return is resource intensive, with large volumes of funds and a reduced time prescribed period, non-compliance risks will be increased;
> - The reduced timeframe will result in the audit process commencing whilst the accounting process is still being completed, leading to further time pressures which may impact the accuracy of the year-end accounts preparation; and
> - The 31 October deadline coincides with the quarterly ABN Return lodgement dates for these funds which further impacts the resource demands and the accuracy of the various returns. (sub. DR61, pp. 4–5)

On the issue of the costs involved, the Institute of Chartered Accountants in Australia also provided estimates of the costs incurred by one large trustee in attempting to meet the deadline:

> From discussions with members in relation to the impact this deadline has had on themselves and their clients it was reported:
>
> - one trustee has spent up to $450 000 on temporary staff to prepare accounts
> - one auditor reports that as at 9/10/01 they are awaiting information from unlisted trusts for up to 300 funds
> - trustees have incurred significant costs in providing fund members with annual reports and detailed information that the member typically provides to the trustee initially or has full access to on request. The preparation of this information is an unnecessary cost to the funds and is adversely impacting members retirement benefits. (sub. DR61, p. 5)

The Trustee Corporations Association of Australia, for example, said:

> The Association reiterates the concern it expressed in its initial submission in May that the lodgment period of four months for [small APRA funds] is unrealistic given the information that needs to be received from other entities, such as managed funds, before the annual returns can be prepared.
>
> We submit that it is also inequitable to impose a shorter lodgment period on [small APRA funds] than on self-managed superannuation funds … supervised by the ATO. An extension in the lodgment period for [small APRA funds] to 6 months would be a step in the right direction. (sub. DR69, p. 7)

William M Mercer summarised the concerns of other participants in saying:

> We remain concerned about the 4 month requirement for lodging annual returns. Whilst it is extremely difficult to measure the cost impact, this requirement places continuing strain on administration, accounting and auditing resources. These returns must be completed at the same time as funds are struggling to complete the extremely complex superannuation surcharge reporting requirements.
>
> We acknowledge that it is preferable for APRA to receive information earlier rather than later when a fund is in or moving towards financial difficulties or there are other prudential issues. However we are not convinced that the 4 month requirement will result in APRA discovering such cases any earlier. Funds in such a position are the most likely to miss the deadline in any event.
>
> At the very least, we believe that the Commission should recommend that funds be given the option of choosing a date other than 30 June as its year end. This would enable administrators, accountants and auditors to spread their work load more evenly over the year and hence minimise costs. (sub. DR51, p. 6)

PricewaterhouseCoopers raised the prospect of trustees providing APRA with unaudited information on a quarterly basis as an alternative to audited accounts. It commented:

Due the concentration of service providers in the industry the requirement for lodgement of the annual return with audited information within four months of year end is unreasonable and costly. We understand that APRA is planning to collect and analyse unaudited information on a quarterly basis. [PricewaterhouseCoopers] suggest that APRA accept unaudited information for the June quarter on the same basis as other quarters, with audited information required to be provided within six months. This will not impact on information provided to fund members as funds are currently allowed to provide unaudited information to members. Accordingly, the extension of the time to lodge annual returns will not prevent funds from providing information to members on a timely basis.

At a minimum, we believe that due to the workload involved in respect of [small APRA funds] and that [small APRA funds'] members typically have access to all fund information on a timely basis, it is appropriate for the deadline for lodgement for [small APRA funds] to be extended to six months after year end.

We note that APRA's view is that a substantial amount of audit work should be undertaken during the year rather than at the end of the financial year which APRA believes would be a good outcome. This is what already occurs for large funds. However, there are a number of key areas which require substantial year end work such as investments and taxation. In respect of small funds, there may be few transactions throughout the year with contributions made close to year end, with little advantage in auditing prior to year end. (sub. DR63, p. 1)

Assessment

In assessing the four-month lodgment deadline, the Commission notes the substantial improvement in compliance with the reporting requirement in its second year of application. Nonetheless, APRA has expressed the view that the number of funds which failed to comply in the latest year remains unacceptably high. The success of APRA's efforts to achieve satisfactory compliance will be clearer when returns for the 2001-02 year are submitted. The Commission considers that, unless there is evidence of intractable problems in meeting the deadline, the four-month lodgment period is appropriate as it provides for timely intelligence on fund operations required for APRA to discharge it supervisory responsibility effectively.

Should this prove not to be the case, alternatives to the current arrangements will need to be considered. The most practical means of addressing the problem would be for the ATO to grant a subset of funds the option of moving to a 31 December reporting date in order to spread the workload on auditing and administration resources more evenly over the course of a financial year. A four-month lodgment period (for the APRA annual return) would still be required. In terms of precedents for such a change, the Institute of Chartered Accountants in Australia commented at the draft report hearings that not all superannuation funds have a 30 June reporting date for taxation purposes. At the same time, it summarised the benefits which would result from an alternative taxation reporting date by saying:

> It is very rigid and that's why we've got … 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 … 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. (trans., p. 333)

Given the large number of superannuation entities and the resource constraints facing APRA and the industry, another alternative would be for APRA to focus on those entities that pose the greatest risk to prudential safety. In terms of the nature of the risks involved, APRA stated:

> It is the second category of funds, those mainly without approved trustees (and numbering around 3000), where there are no licensing arrangements in place and where funds are often managed by amateur trustees, where potential problems have been the greatest. Most regulatory enforcement actions over the past six years have involved funds in this category.
>
> …
>
> The key challenge, therefore, is to devise an effective set of prudential arrangements to deal with these matters in the relatively small proportion of funds, without imposing unnecessary and inefficient constraints on the bulk of well-run superannuation entities. (sub. 36, pp. 4–5)

As small APRA funds (all of which have approved trustees) fall outside APRA's high risk category, a subset of these funds could be permitted (and encouraged) to adopt a common annual reporting date (to APRA) other than 30 June while retaining the four-month lodgment period. Again, this would reduce compliance costs by spreading the workload on auditing and administration resources without compromising APRA's lodgment deadline. This may, however, compromise APRA's ability to compare statistical information across different fund types.

FINDING 5.2

There is good reason to apply as short a period as feasible for lodgment of superannuation funds' annual returns to APRA. This is consistent with efficient management of these entities and assists APRA to discharge its supervisory responsibilities. A four-month lodgment period appears appropriate. Consideration could be given to allowing a subset of funds to adopt a 31 December reporting date for taxation purposes. Another option would be to allow a subset of funds to adopt a common annual reporting date (to APRA) other than 30 June.

Actuarial certificates

The SIS legislation requires that a number of different types of actuarial certificates be given about certain superannuation entities in order to improve the financial security of defined benefits and pension payments. They are funding and solvency certificates for defined benefit funds and the certification of superannuation entities' capacity to pay pensions.

Funding and solvency certificate

The trustee of a defined benefit fund must obtain a funding and solvency certificate from an actuary in relation to the fund. Some funds, including those where the SG does not apply and exempt public sector schemes, are specifically excluded from this requirement.

The funding and solvency certificate must set out, among other things, the 'minimum contributions reasonably expected by the actuary to be required in respect of any member or class of members to secure the solvency of the fund on the expiry date of the certificate'.

The funding and solvency certificate is valid for a period of not less than 12 months and not more than five years from the date on which it takes effect.

Objective

The purpose of the certificate is to aid in the prudent management of defined benefit funds and to protect member benefits.

Costs

Some participants indicated that certain aspects of the requirements are imposing significant additional compliance costs in return for benefits of doubtful value.

William M Mercer expressed the following concerns:

> Such a certificate must set out the minimum employer contribution rate over the period of the certificate to maintain assets above the "minimum requisite benefits" ie the minimum benefits required for SG purposes. Such a certificate can however mislead trustees and employers into a false sense of security, as this minimum contribution rate, whilst sufficient to provide the minimum SG benefits, may be insufficient to provide the benefits defined in the fund's rules.
>
> To counteract this, many actuaries specify a higher than necessary "minimum" contribution rate so that an appropriate contribution rate is maintained. However this

> can often result in the need for a further [certificate] earlier than would otherwise have been necessary even in circumstances where solvency is not at risk. (sub. 8, pp. 18–19)

This requirement arises from the SIS regulations but is also linked to the SG legislation.

William M Mercer also referred to problems in relation to 'notifiable events' that would trigger the need for the trustee to obtain a new funding and solvency certificate:

> Adverse events occurring are not being notified to the actuary because the trustee has either forgotten about the requirements of the [certificate] or because the particular event was unforeseen and not specified in the [certificate].
>
> [There are] requirements in the Regulations to replace [a certificate] even though it may be obvious to the Actuary that no adverse solvency issues have arisen. (For example, the [certificate] might require the trustee to advise of a significant level of salary increases. The mere notification can trigger the requirement for a new certificate yet the fund could still be in a very sound financial position because of the higher than expected investment returns.) (sub. 8, p. 19)

Assessment

The Commission recognises that the funding and solvency certificate is essential in providing information to trustees and members, as well as to APRA and the ATO, about superannuation entities providing defined benefits. However, some aspects of the requirements are imposing unnecessary costs in terms of meeting the objectives of the SIS legislation. This suggests that a technical review of the existing requirements should be undertaken with a view to simplifying them.

Pension certification

Superannuation entities paying pensions are required, by Modification Declaration 23 (issued by APRA in January 1999), to have an annual actuarial investigation and a statement as to their capacity to pay pensions under the funds' governing rules. The actuarial certificate is not required for funds that provide pensions wholly through the purchase of annuities issued by life insurance companies, or for funds paying allocated pensions. APRA has discretion to vary the investigation and certification period from one to three years for some funds that are not self-managed superannuation funds or small APRA funds.

The Institute of Actuaries of Australia noted that, for the actuary to provide a positive opinion, the legislation effectively requires there to be a 70 per cent (or higher) probability that the assets are adequate to pay the pensions specified in the fund's governing rules. The Institute stated that 'this generally compels a higher level of asset coverage than is required for other purposes' (sub. 16, p. 7).

Objective

The purpose of the actuarial certificate under Modification Declaration 23 is to protect member benefits by helping to ensure that the superannuation entity has sufficient assets to meet future pension payments.

Costs

Participants expressed several concerns in relation to pension certification under Modification Declaration 23. The Institute of Actuaries of Australia considered that a review of pension certification is warranted because:

- it fails to increase the security of superannuation fund pensions, as it appears that the legislation effectively allows downwards adjustment of lifetime pensions after they have commenced to be paid, rather than requiring assets to be sufficient to meet the Act's probability test at the commencement of payment;
- it places additional costs on large funds, for the vast majority of which the adequacy of total fund assets to meet the relatively small pension liabilities is clear;
- the consequences of failing to meet the 70% test are unclear; and
- it is inconsistent with the requirements of the other legislation (eg the ITAA). (sub. 16, p. 7)

In addition to pension certification specified in the SIS legislation, members of funds in receipt of complying pensions are subject to the deprivation guidelines applied by the Department of Family and Community Services. Under those guidelines the Department:

> … requires that social security customers with [asset test exempt] income streams sourced from SMSFs and [small APRA funds] provide the annual actuarial certificate as a condition for the income stream continuing to receive an exemption under the [age pension] asset test. (sub. 44, p. 1)

The deprivation guidelines give effect to the social security principle that 'people should use their own income and assets to meet their day to day needs before calling on the community for income support' (sub. 44, p. 2). This is achieved by determining a commercial value for the income stream provided by the fund and treating any excessive capital provisioning for the income stream as an asset for application of the age pension asset test.

The Institute of Actuaries of Australia commented that this 'overall defined benefit pension regulatory regime (encompassing tax and social security requirements as well as provisions of the SIS legislation) is unnecessarily complex, contradictory and inefficient, particularly for self-managed superannuation funds' (sub. 16, p. 8).

William M Mercer noted that the system is costly to administer and 'extremely confusing' to the public:

> If a favourable [actuarial] opinion is obtained, the asset test exemption will apply. At the following year's actuarial valuation, it is likely that, unless the fund's investment return has been greater than expected, the reserve will no longer be big enough for the actuary to give another favourable opinion. Thus the asset test exemption will cease. The following year may be a year of strong investment returns that increase the reserve. A favourable certificate from the actuary will result in the asset test again applying for a year with the possibility that the exemption will again be removed the following year. (sub. 8, p. 20)

The Commission understands that the cost of the certification required by Modification Declaration 23 can vary from a few hundred dollars (in a fund with considerable surplus, small numbers of pensioners or where pensioners have first call on assets) to potentially $10 000 (although it is rare for costs to be this high). When a pensioner requires a positive certification to obtain an exemption from the social security asset test, the Commission understands the cost to be at least $600 each year in addition to the normal valuation cost. Where the asset test exemption is not required, the actuary would normally give a negative opinion in order to minimise cost.

William M Mercer considered that the need for some superannuation entities providing certain types of pension benefit to conduct an actuarial valuation each year (Modification Declaration 23) is 'unnecessary, resulting in significant additional costs' (sub. 8, p. 19). It said the requirements were likely to discourage some funds from providing benefits in pension form. While William M Mercer noted that larger entities in a strong financial position can apply to APRA for less frequent valuations (up to three yearly), there are still costs involved in preparing the application and resubmitting these every three years.

Many of the complexities and costs arise from the different objectives of Modification Declaration 23 and the social security deprivation provisions (box 5.1). Nonetheless, the Department of Family and Community Services argued that the two sets of requirements represent a 'considered, logical response' to ensure that the reserving provisions of Modification Declaration 23:

- do not encourage social security customers to purchase income stream products that give an inappropriate low level of income compared to what could be purchased elsewhere in the marketplace; and

Box 5.1 **Interaction between Modification Declaration 23 and deprivation**

Prior to 1998, the market for superannuation pensions was supplied by relatively secure funds managed by life insurance companies or sponsored by large employers. A wider range of superannuation funds entered the market following changes to the social security assets test exemption. APRA's concern was that some of these funds may not have sufficient capital to ensure the payment of pensions over the long term. Accordingly, it introduced Modification Declaration 23. This requires all funds paying pensions (with the exception of funds paying allocated pensions and annuities issued by life insurance companies) to produce an actuarial certificate that there is a 'high degree of probability' that pensions will continue to be paid.

Modification Declaration 23 also addressed Department of Family and Community Services concern that if a fund is unable to meet its obligations to a social security customer, the Government would have to provide additional financial support. However, it also had the effect of providing an opportunity for a SMSF member to 'over-reserve' assets for the purpose of estate planning. Specifically, the lack of a commercial 'arm's-length' arrangement between the trustee and beneficiary provided social security recipients with SMSFs the opportunity to 'over-reserve' assets in order to qualify for, or increase, social security benefits (with any excess assets after death left to estate beneficiaries). Clearly, this conflicted with the social security objective of a needs-based system in which people use their own assets and income before seeking assistance from the Government. To address this problem, the deprivation provisions were applied to superannuation.

SMSFs and small APRA funds have a small population of lives over which they can spread lifetime risk compared with institutional fund providers. As a result, they must reserve at higher levels than institutional providers. This means that, for a given level of assets, a SMSF or small APRA fund member will receive a lower income stream than a member of an institutional fund. Therefore, despite having equal assets, a social security customer with a SMSF or small APRA fund would receive a higher pension than those received by a social security customer with an investment in an institutional fund. Deprivation provisions were introduced to limit this effect.

Deprivation provisions are applied when Centrelink considers that the level of income is unusually small relative to the capital from which that income is derived. To assess deprivation, Centrelink asks the Australian Government Actuary to compare the value of the income stream with the capital value of the fund. Any value of the fund capital above that required to procure the income stream is considered deprivation and is included in the asset test. Where there is an 'arm's-length' relationship between the beneficiary and fund, Centrelink generally accepts that there has been no deprivation.

The application of deprivation provisions to SMSFs and small APRA funds was a necessary response to limit the potential to 'over-reserve' under Modification Declaration 23. It has created a system, albeit complex, whereby Modification Declaration 23 and the deprivation provisions interact in an effort to address competing policy objectives — APRA's objective that funds maintain adequate reserves to ensure future income payments versus the social security objective that the social security system operates on a needs-only basis.

Source: Sub. 44.

- not give rise to inappropriate estate planning opportunities.

> The taxpayer would effectively subsidise both of these outcomes which is not a desirable outcome of social security policy. (sub. 44, p. 5)

Participants' response to the draft report

In the draft report, the Commission proposed that the requirements for actuarial certificates be simplified by APRA in consultation with the Institute of Actuaries of Australia.

Few participants commented on the Commission's proposal as it would apply to pension certification. However, the Institute of Actuaries of Australia said:

> We particularly welcome the Commission's recommendation and would welcome the opportunity for discussion with APRA in this regard. However, the Commission should be aware that the pension certification requirements discussed in their report had their origins in social security requirements, rather than being an APRA initiative. Therefore change to these requirements may not be entirely within APRA's control. (sub. DR55, p. 3)

Also, the Institute of Chartered Accountants in Australia commented:

> We would like to see input provided to this process by the ATO to ensure that the requirements for actuarial certificates *for the purposes of claiming pension income deductions* are considered [as required for taxation purposes]. We would see this as an opportunity for alleviating the need for actuarial certificates for funds providing allocated pensions in particular self managed and small APRA funds. (sub. DR61, p. 3) [emphasis added]

Assessment

Pension certification under Modification Declaration 23 helps to ensure that funds have sufficient reserves to meet future pension payments. The certificate is also required by Centrelink for application of the deprivation provisions to asset test exempt income streams. However, the Commission agrees with those participants who consider that the requirements are imposing unnecessary costs in terms of meeting the objectives of the SIS and social security legislation.

Given that funding and solvency certificates, as well as the pension certification requirements under Modification Declaration 23, are imposing excessive actuarial requirements on superannuation funds, a technical examination of these requirements is warranted.

RECOMMENDATION 5.5

The requirements for actuarial certificates should be simplified by the Australian Prudential Regulation Authority, in consultation with the Institute of Actuaries of Australia, the Department of Family and Community Services and the Australian Taxation Office.

6 The SIS legislation: other provisions under review

This chapter examines other provisions of the SIS legislation which are either fundamental to the achievement of the legislation's objectives or the subject of some participants' concerns about their effects on competition and compliance costs. These provisions include certain trust and trustee requirements, certain requirements imposed on the operations of superannuation entities, investment rules, provisions defining annuities and pensions, the exemption of certain public sector superannuation schemes and administration matters. The Commission considers these provisions to be largely effective in meeting their objectives, and that their benefits outweigh their costs.

Earlier chapters have focused on those provisions of the SIS legislation under review which have been identified by the Commission as involving restrictions on competition or imposing significant compliance costs which could be reduced through more cost-effective means of achieving the objectives of the legislation.

This chapter examines some other provisions of the SIS legislation. These are either fundamental to achieving the objectives of the legislation or are a concern to participants. They include:

- certain trust and trustee requirements;
- certain requirements imposed on the operations of superannuation entities;
- investment rules;
- provisions defining annuities and pensions;
- the exemption of certain public sector superannuation schemes; and
- administration matters.

Not covered in this chapter are a number of other provisions of the SIS legislation about which participants raised no concerns or which are of an ancillary nature. Among these are provisions relating to notices about complying fund status (part 5), suspension or removal of trustees (part 17), civil and criminal consequences of contravening civil penalty provisions (part 21), the facility to pay benefits to eligible rollover funds (part 24), the monitoring and investigation of superannuation entities (part 25), offences (part 26) and court powers (part 27).

6.1 Trust and trustee requirements

A trust focus

The language of the SIS legislation in many places reflects the language of the general law of trusts. A trust is generally a means for managing personal wealth and ensuring that this wealth is channelled to certain persons or for certain purposes (box 6.1).

Box 6.1 **The characteristics of a trust under general law**

Trust law first developed in the English court of equity in the fourteenth century. A trust exists if the following four characteristics are present:

- there are one or more trustees, individuals or corporations, who hold a legal interest in the trust property;
- there exists trust property capable of being held on trust which is certain and identifiable;
- the trustee holds the trust property for the benefit of a beneficiary or object; and
- the trustee is under a personal obligation to deal with the trust property for the benefit of the beneficiaries. This personal obligation is annexed to the trust property.

Source: Meagher and Gummow (1997).

According to the legislation, a superannuation entity by definition must have a 'trustee' (but need not strictly be a 'trust'). A trustee is defined in terms of the 'ordinary' meaning of the expression, or is 'a person who manages the fund, scheme or trust'. Similarly, there is reference to other general law trust concepts such as 'beneficiary' and 'beneficial interest' and the 'vesting' of property (secs. 10(1) and 138).

The SIS legislation does not exclude the operation of the general law of trusts in relation to superannuation entities; the general law continues to apply unless expressly excluded by the legislation, or by the provisions of the trust deed (Dal Pont and Chalmers 2000, p. 725).

The trustee is effectively the sole 'responsible entity' under the SIS legislation. Although the expression does not appear explicitly in the SIS legislation (as it does in the *Managed Investments Act 1998*), trustees have many obligations under the legislation with respect to superannuation entities, the contravention of which is subject to strict penalties (see later).

Assessment

Trusts are perceived widely to be highly suited to, and to have worked well in, ensuring the prudent management of superannuation entities. For example, the Association of Superannuation Funds of Australia (ASFA) said:

> The trustee system has long been the accepted mechanism for managing superannuation funds both in Australia and throughout the Anglo-American world. … maintaining the trustee structure is paramount for the sound prudential management of superannuation funds. The trust relationship, with its origins in English common law, provides a simple, strong and flexible structure within which superannuation funds can operate. The main principle of trusteeship, namely a trustee designated to administer funds in the best interests of the beneficiaries, is suited to superannuation with its long term objectives, large number of often financially unsophisticated members and rights enjoyed by non-member beneficiaries. The compulsory nature of superannuation reinforces the need to maintain a governance approach that is strong yet flexible. … there is a body of common law that exists around which a principle based regulatory regime can be structured. Where prescription is required or desired this can be achieved by legislating exceptions to the trustees duty under trust law. (sub. 15, p. 4)

The focus of the SIS legislation on a sole responsible entity — the trustee — also provides certainty amongst members and to the regulator about who is legally responsible for the management of contributions and assets, and who will be held liable if anything goes wrong. This is particularly important where other parties, such as investment managers and administrators, are involved in the operations of the superannuation entity.

However, in certain limited circumstances, the requirement to establish a trust structure may impose additional compliance costs on some providers of superannuation products for little gain in prudent management. For example, APRA noted that a small proportion of superannuation assets is written in the statutory funds of life offices as deferred annuities and a further proportion is written under a trust structure where the trustee is either a subsidiary of a life company or a third party under the 'clear understanding' that all assets of such trusts will be invested in the statutory funds of the life company. It said:

> This creates an additional layer of regulation that serves no good purpose and, in the case of the subsidiary trustee, creates the illusion that the subsidiary sits on top of the parent life company and statutory fund. (sub. 36, p. 7)

Similarly, Phillips Fox said in relation to some public offer superannuation funds:

> … where the trustee is a wholly owned subsidiary of a financial institution and there is no representation by members, little is achieved by the added expense of trusteeship. It may even cause members to believe they are receiving a level of duty that is not necessarily there. Clearly, there is a fundamental conflict where associated entities of the trustees are acting for profit. (sub. 18, p. 2)

Indeed, the existence of retirement savings accounts and annuities — superannuation products provided by prudentially supervised corporations under contracts — suggests that a trust structure can be avoided in some situations. These two products account for less than one and about 7 per cent, respectively, of total superannuation assets (derived from APRA 2001k, table 1b).

Some participants supported this view. APRA considered that there was scope for reducing 'unnecessary duplication and complication' by allowing all superannuation assets in life office statutory funds to be written by way of contracts between members and the life company, rather than by an interposed trustee (sub. 36, pp. 7–8). Phillips Fox noted that:

> … if you were to provide for the option of not having a trusteeship, one would look closely at … the regulation of life companies because there's a long history of investment products without trusteeship. It's purely a contract, clearly with a prudential overlay, statutory funds, and all that sort of thing. (trans., p. 70)

FINDING 6.1

The trust basis of the legislation is effective in facilitating prudent management of superannuation entities. Nonetheless, there may be scope to extend the range of prudentially supervised corporations which can provide superannuation products without a trust structure.

In their responses to the draft report, many participants supported the first part of this finding.

Some participants, however, did not support the second part. The Industry Funds Forum, for example, expressed 'grave reservations' concerning the possibility of extending the range of prudentially supervised corporations which can provide superannuation products without a trust structure (sub. DR57, p. 1). This matter is considered in chapter 7.

Trustee representation

'Standard employer-sponsored funds' are generally required to comply with requirements governing trustee representation (part 9 of the Act). A standard employer-sponsored fund is a regulated superannuation fund that has at least one standard employer sponsor (secs. 10(1) and 16). A standard employer sponsor is generally an employer who contributes to the fund pursuant to an arrangement between the employer and the trustee of the fund.

Equal representation rules are a core feature of the trustee representation requirements (sec. 89). A standard employer-sponsored fund complies with the rules if:

- it has a group of two or more individual trustees; and
- the group of trustees consists of equal numbers of employer representatives and member representatives;

or

- it has a single corporate trustee; and
- the board of the corporate trustee consists of equal numbers of employer representatives and member representatives.

The group of trustees, or the board of the corporate trustee, may have an additional 'independent trustee' or 'independent director', if this is requested by member or employer representatives and the fund's governing rules provide for such an appointment.

The SIS legislation does not explicitly require elections to be held to appoint trustee representatives or to fill vacancies. (Where a vacancy arises, the legislation provides that a fund is taken to have complied with the equal representation rules under certain circumstances which do not involve the holding of elections — sec. 89.) According to Circulars III.A.2 and III.A.3, APRA requires vacancies to be filled in accordance with 'established procedures'. These may include 'a new nomination and appointment process', 'appropriate fallback arrangements' such as 'appointing the next highest unsuccessful candidate from the last election' or, at the time of nomination, member nominees declaring a specific substitute should they leave during the term of their representation (for example, APRA Circular III.A.2, para 71).

Assessment

The equal representation rules seek to foster the prudent management of standard employer-sponsored funds by trustees representing the interests of all the fund's members.

In particular, trustees — who include members with an interest (or holding) in the fund — are likely to have a greater incentive than more 'arm's length' trustees to ensure that decision making with respect to the fund reflects member interests. The Australian Institute of Superannuation Trustees (AIST) said:

> Significant benefits [of requirements for equal representation] are:
>
> - Greater diversity on trustee boards — they are therefore more representative of the membership as a whole.
> - More women on trustee boards than in the corporate environment.
> - Commonsense approach to decision making.
> - Minimises influence of informal networks on the composition of trustee boards. (sub. 19, part 2, p. 3)

Also, the appointment of members as trustees may diminish the potential for fraud and malpractice that might otherwise occur, as members are likely to be vigilant in overseeing the fund.

However, APRA has noted problems with a number of small employer-sponsored funds. Typical problems encountered included non-arm's length transactions and poor investment decisions and trustee/directors' use of fund assets for their own benefit (sub. 36, p. 5).

The equal representation rules may also lead to greater confidence by members in their trustees. For example, Finlaysons said:

> … the equal representation requirements have provided unquantifiable benefits in the overall confidence of members in the operation and management of their superannuation funds. This level of confidence is inspired by the actions of the trustees themselves and the recognition that in many cases they have an ability to nominate and vote for trustee member representatives. (sub. 17, p. 4)

However, there is a cost in finding persons who are willing to become trustee representatives, particularly if elections are conducted (even though as noted earlier this is not required under the SIS legislation). William M Mercer said:

> From an administration point of view, the requirement for elections [sic] etc has obviously meant an increase in costs.
>
> Because of the turnover of employees, either due to resignation, retirement or transfer to distant locations, it is often necessary to replace a member appointed trustee much earlier than the date that the trustee's term of office would normally have expired.
>
> It is important that costs be kept to a minimum and that a practical mechanism of finding replacements for casual vacancies be implemented. (sub. 8, p. 22)

William M Mercer, while noting the methods of filling vacancies in APRA Circulars III.A.2 and III.A.3, suggested as an alternative:

> A more appropriate approach would be to allow the remaining member representatives to nominate a replacement. This approach was previously accepted by APRA. However, more recently, APRA has indicated that it is not acceptable unless there is a short period until the next election. In our view it is the most logical and practical means of filling a vacancy and results in considerably less cost than holding another election (sub. DR51, p. 7)

The Institute of Actuaries of Australia noted the difficulty of finding persons willing to volunteer as trustees:

> … the burden on trustees is becoming too great, given:
>
> - the burgeoning volume of superannuation legislation
> - the increasing complexity of the legislation; and
> - the increasing legal burdens on trustees, such as the recent strict liability changes.
>
> This is making it more and more difficult to find unpaid volunteers to act as trustees. (sub. 16, p. 7)

There is also a cost in having to train trustee representatives to attain a level of competence. Again, William M Mercer said:

> … by establishing [an equal representation] system, many trustees are inexperienced in the trustee role. Appropriate trustee training is necessary … it must be remembered that many trustees are ordinary workers with no significant financial skills. (sub. 8, p. 9)

Another problem of the rules was raised by Finlaysons which noted concerns expressed to it by corporate fund trustees that:

> … while industry funds meet the equal representation requirements, member representatives are often appointed through nomination by a trade union rather than by direct nomination and election by members. (sub. 17, p. 4)

FINDING 6.2

The equal representation rules for trustee boards of standard employer-sponsored funds provide balanced representation of employer and employee interests. They are conducive to active member interest in the prudent management of these funds. This benefit exceeds the cost of finding and appointing members who are capable of undertaking trustee duties.

In their responses to the draft report, many participants supported this finding. However, one participant noted that equal representation may not always work as well as intended. Although the Industry Funds Forum unequivocally endorsed equal representation rules, it said at the draft report hearings:

> ... some funds purport to have equal representation but the reality is somewhat different and that people who are ostensible member representatives are in fact quasi-employer representatives. ... in the absence of member election or union appointed trustees, it

sometimes bears a bit closer scrutiny to determine whether member elected trustees are as they seek to represent themselves, or as others might seek to represent them. (trans., p. 404)

Policy committees

The legislation provides that, where a standard employer-sponsored fund that is a public offer superannuation fund — typically, a master trust — chooses not to meet the equal representation rules, it must have an 'independent trustee' and, in addition, may be required or requested to establish a policy committee (secs. 92 and 93, reg. 3.05, APRA Circular III.A.3). A policy committee must have equal numbers of member and employer representatives (reg. 3.05). It provides an avenue for:

- members to inquire about such matters as the investment strategy and performance of the fund; and
- trustees to obtain members' views, inquiries and complaints (reg. 3.06).

However, a policy committee cannot limit the responsibilities of a trustee; nor can it give directions to a trustee (reg. 3.06).

Trustees have specific duties in relation to policy committees, including ensuring that as far as practicable the committee meets at least once a year (reg. 3.08).

Assessment

Some participants questioned the value of policy committees. Finlaysons said that 'policy committees in master trusts have been seen [by corporate funds] to be of limited value because they have no power to direct trustees' (sub. 17, p. 4). Also, Phillips Fox said of policy committees for master trusts:

> These are rarely operated and are often considered to be a burden by the financial institution and employer. They have no real power as the trustee need not act on their recommendations. However, these committees perform a vital role in representing the employer group and its [members]. (sub. 18, p. 2)

Policy committees do provide a communication channel and an opportunity for members and employers to express their views about the conduct of master trusts. Indeed, PricewaterhouseCoopers said that, given the changes in the market, the role of policy committees is becoming increasingly important:

> ... as we see larger corporates oursourcing, we feel that the role of the policy committee is going to become increasingly important and it shouldn't be used as lip service. There is a real role there to make sure that the master trusts and the industry funds or whoever the approved trustees are, are being appropriately monitored — not to the same extent

of having a separate trustee board but in making sure that the service standards are right; that they are being benchmarked; that communications are hitting the mark with members and are representative of particular corporate members rather than necessarily generic; that the investments and investment performance and management of the investments are being properly benchmarked and communicated through; that it is being prudently managed. They're just a couple of things. (trans., p. 441)

FINDING 6.3

Policy committees in master trusts are a relatively low-cost means of facilitating the exchange of views between trustees, members and employers.

Application of the Criminal Code and strict liability to offences

The SIS legislation was amended by the *Financial Sector Legislation Amendment Act (No.1) 2000* to apply the Criminal Code[1] and to change the status of some offences from fault to strict liability, or from fault to two-tier fault and strict liability. The approach is similar to that applying elsewhere in the financial sector — for example, in the life insurance and banking industries.

The offences that have been converted to strict liability, or two-tier fault and strict liability, are those relating to requirements for the 'prudent operation' of a superannuation entity (such as lodging annual returns, keeping minutes of trustee meetings and other records, and providing information to regulators). For example, failure of an 'approved trustee' to notify APRA of any breaches of the conditions approval is now a strict liability offence rather than a fault-based offence (sec. 29(4)).

Strict liability essentially means that someone who contravenes the legislation is liable to prosecution even if the contravention could not have been avoided by the exercise of due or reasonable care. The revised Explanatory Memorandum stated:

> While strict liability offences do not require prosecution to prove fault elements (such as intention or recklessness) the prosecution nevertheless has a legal burden to prove beyond reasonable doubt the physical elements of the offence. Once this has been established by the prosecution, the onus shifts to the defendant to show why criminal responsibility should not apply (e.g. by raising a defence). (Parliament 2000)

1 The Criminal Code codifies common law principles relating to criminal responsibility. The amendments to the SIS legislation ensure that it applies to the new offences.

Assessment

Stronger penalties for contraventions of the SIS legislation can improve the incentives for compliance by trustees (both individuals and corporations) and, thus, contribute to improved prudent management. In particular, strict liability offences enable APRA to enforce compliance by trustees with the SIS legislation more effectively by reducing the evidential burden it must show to prove a prima facie case of breach. The penalties also may deter less competent people from becoming trustee representatives. As noted in the revised Explanatory Memorandum, the new penalty provisions:

> … strengthen the regulatory framework for superannuation and enable more effective enforcement of compliance with basic obligations under the SIS Act. This in turn will assist in ensuring that superannuation entities are administered prudently and that superannuation savings are adequately protected. (Parliament 2000)

However, the new penalty provisions could discourage capable members of employer-sponsored funds from volunteering to become trustee representatives. The AIST noted that:

> [They] may be discouraging more people from taking on the role.
>
> … Coles Myer is about to conduct its next elections for member elected trustees of the Fund. The number of candidates is approximately 1/3 of the number that nominated for election 3 years ago. (sub. 19, part 2, p. 3)

William M Mercer said the provisions are likely to:

- further encourage corporate funds to wind up, or
- discourage appropriately qualified members from seeking election as a trustee. (sub. 8, p. 13)

There is also an issue about how APRA will enforce the new penalty provisions, particularly where volunteer trustees are involved. ASFA said:

> The failure of APRA to issue a circular outlining how it intends to act has the potential to result in funds incurring significant costs when a more appropriate way to rectify minor breaches could have sufficed. … Until such time as the regulator issues a circular on the subject uncertainty will remain. The uncertainty also has the potential to undermine the largely voluntary and representative trustee base of corporate and industry funds. (sub. 15, p. 18)

FINDING 6.4

The application of the Criminal Code and strict liability penalty provisions to some offences may deter capable members from volunteering to become trustee representatives of employer-sponsored funds. Accordingly, it would be desirable that APRA issue guidelines to clarify how it intends to exercise its discretion in the *application of these provisions. This would reduce the likelihood of members being deterred by uncertainty about the application of the penalty provisions.*

In their responses to the draft report, several participants supported this finding, particularly the desirability of APRA issuing guidelines on how it intends to exercise its discretion in the application of these provisions.

6.2 Requirements governing operations of superannuation entities

In addition to the operating requirements discussed in chapter 5 which, in the Commission's view, could achieve their objectives in a more cost-effective manner, participants raised a number of other requirements where they believed modifications were justified. The most prevalent comments dealt with the sole purpose test and successor fund transfers.

Sole purpose test

The provision of benefits by regulated superannuation funds is limited by the sole purpose test to a number of specified core or ancillary purposes related to the provision of retirement incomes (sec. 62, regs. 1.03 and 13.18).

The test provides that a regulated superannuation fund must be maintained for at least one of the core purposes of the legislation or for at least one of those core purposes and for one or more of the specified ancillary purposes. Core purposes are essentially the provision of benefits on or after the date when a member retires, reaches age 65 or dies (APRA Circular III.A.4). Ancillary purposes are the provision of employment termination insurance, salary continuance (on a member's cessation of work because of ill health), reversionary benefits and other approved benefits on or after an appropriate condition has been met.

The sole purpose test operates in conjunction with the contribution, payment and accrual standards set out in the SIS legislation.

Assessment

The key objective of the sole purpose test is to ensure that superannuation assets and contributions are used to provide some form of retirement benefit. The test, and the associated standards, are intended to achieve this by prohibiting the use of tax concessions for purposes such as providing pre-retirement benefits to members, benefits to employer sponsors or facilitating estate planning.

The sole purpose test could involve a cost if it restricts the provision of a range of ancillary services which could be offered to members and still meet the key objective of the test. For example, the provision of financial advice by a regulated superannuation fund could contravene the sole purpose test, even though the advice relates to the retirement benefits of the fund.

Some participants considered that the test is unnecessarily restrictive and that there is scope for increasing its flexibility. The Queensland Government Superannuation Office said:

> … most superannuation fund members would require quality financial planning services and access to non superannuation savings vehicles to fully meet their retirement planning needs. With the introduction of the superannuation surcharge, and since many more members are exceeding or likely to exceed the Reasonable Benefit Limits, superannuation is not always the most tax effective method for members to solve their retirement planning problems. (sub. 41, p. 3)

And the AIST noted that:

> The “Sole purpose” test could be modified to provide a greater flexibility for funds in providing other benefits related to members’ retirement savings, such as investment advice. (sub. 19, part 2, p. 3)

The test might also add to costs incurred by funds. The Queensland Government Superannuation Office considered that, in order to provide other services, such as financial planning advice, additional structures have to be established.

> … it is currently difficult, if not impossible for such products and services to be offered by employer sponsored superannuation funds without establishing alternative corporate structures which adds a layer of complexity and cost which is often restrictive, and could be considered anti competitive. (sub. 41, p. 3)

Finlaysons noted that the test had led to trustee confusion in the past about the type of benefits that could be provided:

> … for a number of years funds felt constrained by the sole purpose test as to exactly what types of benefits that they could offer. Then through a process of evolution and going to either the [Insurance and Superannuation Commission] or APRA, they have received approval or at least a recognition from the regulator that the provision of a certain benefit would not breach the sole purpose test … . (trans., p. 218)

However, broadening the test could lead to further problems. Finlaysons said:

> As these additional benefits start to be offered the real conundrum for the Government is, “Well, superannuation is concessionally taxed”, so if we’re going to give that tax

> concession there should be some limits on what can be done with that money. (trans., p. 218).

Concessionally-taxed superannuation assets and contributions are designed to provide for retirement benefits. Thus, limiting the types of core and ancillary services provided by superannuation funds to those related solely to the provision of retirement benefits is consistent with this objective.

While the test might appear to be overly restrictive in prohibiting certain services, there is a risk that extending the range of services provided may weaken its key objective. This could occur both through increased uncertainty as to the limits of what may be provided and through the interaction of the sole purpose test with other provisions in the SIS legislation, such as those relating to successor fund transfers (see below). Moreover, the types of additional services sought by some participants (such as financial advice and home loans) are readily available through a range of commercial providers.[2]

In response to this assessment of the sole purpose test, the Commission found in the draft report that the test was necessary to achieve retirement incomes policy objectives and should be retained. Participants who commented on the draft finding supported it. Jacques Martin Industry Funds Administration Pty Ltd (Jacques Martin) essentially concurred with the Commission's assessment while PricewaterhouseCoopers said that it:

> … accepts the Productivity Commission's draft finding, based on our understanding that funds will continue to offer members "generic" financial options in their retirement which may be paid for by the fund. "Tailored" financial options should be paid for by members individually. With the introduction of the Financial Services Reform Act this issue becomes increasingly complex. (sub. DR63, p. 2)

FINDING 6.5

The sole purpose test, which restricts the range of services that superannuation funds can provide to their members, is necessary to achieve retirement incomes policy objectives and should be retained.

2 Funds already provide indirect access to home loans for their members and on quite favourable terms through affiliation arrangements with financial services organisations. They also invest in securitised mortgages offered by mortgage originators as part of their portfolio allocation process. The benefits of amending the sole purpose test to allow for direct provision, therefore, appears limited.

Successor fund transfers

As noted in chapter 5, the payment standards contained within the SIS legislation determine (among other things) when a regulated superannuation fund may either roll over or transfer a member benefit. In most circumstances, the transfer of superannuation benefits to a new fund requires consent from each affected member. When a successor fund transfer occurs, individual member consent is not required. Successor fund provisions (regs. 1.02, 6.2 and 13.16) are designed to facilitate the winding-up of funds in a more efficient manner.

The SIS Regulations (reg. 1.03(1)) define the conditions under which a transfer of benefits can be made to a successor fund. These are:

- the fund confers on the member 'equivalent rights' to the rights that member had under the original fund in respect of the benefits; and
- before the transfer, the trustee of the fund has agreed with the trustee of the original fund that the fund will confer on the member 'equivalent rights' to those the member had under the original fund in respect of the benefits.

Trustees are likely to use successor fund provisions where they seek to rationalise a number of funds or where an event necessitates the transfer of members (for example, when an associated employer leaves a corporate fund or master trust).

In February 2001, APRA sought to clarify the definition of 'equivalent rights' (APRA Circular I.C.4). This was in response to concerns expressed by some sections of the superannuation industry regarding the meaning of this term.

Assessment

The successor fund transfer provisions enable trustees to take advantage of administrative cost efficiencies arising from transferring a group of members from one fund to another without requiring consent of each and every member and without reducing member benefits. Corporate Super Association noted:

> Those provisions have worked efficiently … when it has been properly done in a small defined contribution plan where it is no longer efficient to maintain the arrangement in-house, because of the regulatory burden, so you outsource it and provided you get the investment strategy more or less right and you get the insurance arrangements continuous and more or less right, there should be no problem. It is quite efficient and you avoid going out and getting the 50, 100, 200, 500 signatures, which is what you would otherwise have to do. (trans., pp. 112–13)

The provisions, in principle, also provide greater financial safety to members by ensuring that their superannuation benefits are maintained in the event of certain conditions being activated — for example, where an employer decides to switch from one fund type or where the employer ceases making employer contributions to a defined benefit fund (where the trust deed allows this). As discussed below, however, one participant raised concerns regarding the abuse of successor fund provisions and a consequent reduction in employee entitlements.

There is some uncertainty about the definition of equivalent rights. Consequent problems may arise as trustees from both the successor and original fund attempt to reach agreement on the transfer of member benefits. (If the original fund has a number of ancillary purposes, agreement may be even more difficult.) On this general point, several participants noted that the definition of equivalent rights had generated confusion within the superannuation industry and, as a consequence, required costly legal advice to clarify the provisions.

Jacques Martin commented that the definition of equivalent rights was restrictive and led to a significant barrier to exit in the superannuation sector. It said:

> The extent to which a fund's benefit design and products confer "equivalent rights" has been the subject of considerable legal opinion and advice since SIS commenced. While considerable lobbying of both the [Insurance and Superannuation Commission] and APRA to clarify their interpretation has resulted in the production of a recent Circular, nevertheless difficulties remain with the application of this concept to different scenarios and [we] suggest that a revisit of the underlying policy considerations may be warranted. (sub. 24, p. 3)

Phillips Fox commented on the significant delays which can arise through the need to obtain agreement from trustees of both the new and original superannuation fund. It said:

> There are a number of conditions attached to a successor fund transfer, but there is a difference of opinion about the interpretation of some of these. Since the trustees of the two funds both have to agree, there can be significant delays in the transfer from one public-offer fund to another while the current trustee obtains legal advice (at the employer's expense). We have encountered cases where the transfer has taken six months due to this tortuous process.
>
> Better guidelines for successor fund transfers are needed. (sub. 18, p. 4)

Corporate Super Association noted the potential for the successor fund provisions to be abused. It had observed certain instances where the provisions (despite the equivalent rights condition) had been used to convert a defined benefit fund into an accumulation fund in order to alter the employer's superannuation obligation. It said:

> … where the successor fund provisions have been used to convert the type of fund and the nature of the employer's obligation, then in my opinion that's an abuse. Fortunately

> I've not done any myself, but I have looked at ones that have been done which haven't complied [with the requirements]. (trans., p. 113)

It would appear that there is a good case for maintaining successor fund transfer provisions in order to provide a cost efficient means of transferring a group of members between funds in certain prescribed circumstances. The safeguard built in to the legislation of equivalent rights being provided to members is also warranted given that the members' right to consent is waived.

In the draft report, the Commission found that the successor fund provisions were appropriate, although some improvement in the definition and application of equivalent rights was required. The Commission also noted that further investigation was required into whether the provisions could be abused by employers seeking to avoid their obligations, and the need to introduce administrative changes to guard against this.

Participants who commented on this finding generally supported the Commission's draft assessment. Jacques Martin emphasised that it was the concept of equivalent rights, rather than the successor funds provisions per se, which was generating confusion, but it endorsed the draft finding. The Investment and Financial Services Association expressed support for the finding but questioned the need for further investigation of potential abuse. It said that it:

> … supports the thrust of the Commission's draft finding … that the successor fund provisions are appropriate. [The Association] had considerable involvement in the discussion process to produce the current APRA circular on this topic. The considerable issues in interpretation were aired (at length) during this process. The general view taken by [the Association's] members involved has been that the circular is workable enough in practice.
>
> The Commission has expressed a concern that the provisions might be able to be used by an employer to seek to avoid its obligations. It is open to employers to close a superannuation scheme without using the successor fund provisions, and so it would not be correct to say that the successor fund provisions provide a new avoidance avenue. Consequently, [the Association] is unconvinced that further investigation would find wide abuse or avoidance opportunities. (sub. DR68, p. 2)

PricewaterhouseCoopers, on the other hand, proposed a mechanism to guard against potential abuse by employers. It said that it:

> … agrees with the draft finding. In relation to the question of whether the provisions can be abused by employers it may be appropriate to require trustees to obtain legal advice from a party independent of the employer's legal adviser. Alternatively, trustees should be required to demonstrate due process in using successor fund transfers. (sub. DR63, p. 2)

At the draft report hearings, PricewaterhouseCoopers provided greater detail on the nature of its due process suggestion. It commented:

> … I guess our point there was really that, you know, don't just look at the legal side. What's involved in a successor fund transfer is that the old trustees need to be comfortable that where their members are going to is as good as or better than what's currently being provided. …
>
> … So our point there is, what sort of process has the trustee been through from, I guess, a due diligence point of view, rather than just looking at the legalities of the transfer? So looking at the investment options, what's happening from an administration point of view, whether the level of service or the service standard is as good, the insurance arrangement is as good, what's their stacked-on cost? You know, what impact does it have from the employer point of view? Are there any surplus issues, reserve issues, what's happening with reserves and surpluses and things like that - the whole quality of the service and communication, rather than just focusing on the legal side. (trans., p. 438)

The adequacy of the definition of equivalent rights and the extent to which this continues to create uncertainty and unnecessary costs to regulated superannuation funds are unclear as APRA has only recently issued a circular seeking to clarify the definition. Further clarification of the definition may help to reduce the time taken, and costs incurred, by trustees of the new and old funds in reaching agreement on whether the successor fund provisions have been met and for transfers to proceed.

FINDING 6.6

The successor fund provisions are broadly appropriate, although some improvement in the application of the equivalent rights principle could be required.

6.3 Investment rules

A fundamental aspect of the SIS legislation are provisions dealing with prudent investment of superannuation assets. The potential retirement income benefits that a superannuation entity provides for its members depend on the contributions made and the success with which these funds are invested.

There are four kinds of investment risk faced by members of superannuation entities:

- the risk that a trustee will fail to formulate an appropriate investment strategy, including not giving due attention to diversification;
- the risk of non-compliance by trustees with nonetheless well-founded investment strategies;

- the risk of a poor investment performance by the trustee/investment manager; and
- the risk of a general downturn in investment returns across a wide range of asset classes.

To address the first two kinds of risk, the SIS Act contains an investment covenant (sec. 52(2)(f)). This covenant requires trustees to formulate and give effect to investment strategies that have regard to the whole of the entity's circumstances including (but not limited to):

- the risk involved in making, holding and realising investments, as well as the likely return from the investments, having regard to entity objectives and expected cash flow;
- the composition of the entity's investments as a whole, including the extent to which the investments are or are not diversified and the associated risks;
- the liquidity of the entity's investments, having regard to its expected cash flow requirements; and
- the ability of the entity to discharge its existing and prospective liabilities.

The investment covenant is intended to minimise 'the risks associated with reckless, ad hoc or uncoordinated investments' (APRA Circular II.D.1, para 4).

The SIS Act does not specify how trustees must give effect to the investment covenant. APRA has issued a circular which provides trustees with guidance on how to discharge their duties (box 6.2).

In respect of investment decisions, the SIS legislation imposes few direct controls on the nature of an entity's assets except for:

- a general prohibition on borrowing, lending to members and placing charges over entity assets (except in relation to certain derivatives contracts);
- requiring investments to be made on an arm's length basis; and
- restrictions on holdings of in-house assets and acquisition of assets from members and relatives.

These rules are collectively 'designed to limit the risks associated with superannuation fund investments and to ensure that superannuation savings are preserved until retirement and not accessed for current use.' (Parliament 1999). (The last constraint is not under review in this inquiry as it has been specifically excluded by the terms of reference.)

Box 6.2 **Putting the investment covenant into practice**

According to APRA Circular II.D.1, which provides guidance on the investment covenants in the SIS Act, trustees are to:

Formulate and document an investment objective for the entity (or for each sub-plan)

The investment objectives should be documented and capable of being clearly communicated to assist interested parties in understanding the investment approach of the fund. Objectives should be measurable — for example, by means of comparison with a performance benchmark or a desired level of return (such as matching or exceeding the all ordinaries index or consumer price index).

Formulate investment strategies

Trustees must, in formulating an investment strategy, be able to identify, measure and manage the risks associated with particular investments or types of investments. To discharge the duty, trustees must be able to demonstrate through trustee minutes, other documentation (for example, reports from investment advisers) and the actual wording of the strategy that they have considered, at a minimum, the specific issues that must be taken into account under the investment covenant. For example, trustees are to have regard to the diversification of investments as a means of managing risk.

Implement the investment strategies

Where trustees delegate the investment management function, they must ensure that proper selection processes have been undertaken and their due diligence examinations should be documented. The appointment of an investment manager must be in writing. This investment 'mandate' should clearly specify the function to be delegated, investment parameters or constraints, performance standards, reporting processes, fees, termination clauses, ownership of records, dispute resolution and indemnification issues.

Monitor investments

All investments must be regularly monitored and reviewed to ensure that the investments remain consistent with the investment strategy, objective and performance benchmarks. It is recommended that reviews be undertaken at least every six months. Monitoring must take into account any actual or proposed changes to the entity and to external conditions (for example, choice of fund legislation, tax reform, membership profile change, and world financial market developments). Trustees must document the review and monitoring process and any resulting actions.

Participants were supportive of the non-prescriptive approach to investment. For example, ASFA said:

> The current Australian regulatory regime for investments by superannuation entities has many advantages over similar jurisdictions overseas. … [It] provides greater opportunities for competition than exists in many other retirement incomes systems.

> Acting within broad principles of having to construct an investment strategy, trustees are free to seek long-term returns that are in the best interests of members. … This has allowed Australian superannuation funds to [have] returned far better long term returns than funds in many countries with tighter restrictions on investments. (sub. 15, p. 14)

PricewaterhouseCoopers summed up the general opinion that, other than in-house asset rules (which are not under reference), the investment covenant and other investment restrictions are not unduly restrictive or complex (sub. 14, p. 13).

The AIST considered that the flexibility within the SIS Act to offer investment choice within a superannuation entity has stimulated competition between entities:

> I believe there's an enhancement of competition arising from investment choice. I believe that big funds now feel they must provide a degree of investment choice or they will lose members. I can give one example which I think has been a successful sort of trailblazer and is causing other funds to want to follow suit … HESTA, offered a green investment choice or an ethical investment choice … a very large number of their members then chose it and then I noticed many other funds looking around to see how they could compete … the existence of investment choice is allowing funds to become more competitive. (trans., p. 238)

APRA, however, noted that investment choice within superannuation entities was not without risks or costs as administrative systems may not be able to cope with the complexity emanating from offering a range of choices (APRA Circular II.D.1, para. 52).

While the current approach in the SIS Act for dealing with investment risks is supported by participants, comments were made about non-compliance with the existing legislation. APRA expressed concern about a minority of superannuation entities where the investment strategies were not broadly consistent with the SIS Act and outlined its intended response as follows:

> As a first step, therefore, we will be amending existing advice to trustees on asset and portfolio selection to emphasise the need for funds to follow more diversified strategies, where they do not already do so. Further, we intend to act more forcefully in requiring better portfolio balance in those cases where trustees have not taken the spirit of the SIS requirements on investment strategy and portfolio determination into account. … We will be considering the case for more formal legislative amendments to confirm our powers in this area. (sub. 36, p. 9)

Related to this, Phillips Fox suggested a need for the regulator to pay closer attention to 'true to labelling' of investment strategies:

> Some members have lost money due to inappropriate investments made by the fund. For example, one of the issues with the Commercial Nominees situation was the investing of its enhanced cash fund into illiquid non-performing mushroom farms.

> We consider that greater care needs to be taken in ensuring that investment options are *true to label*. If members invest in a cash fund, they have an expectation of capital security — and appropriate assets are required. Although effective disclosure and informed decision making will help, the trustee and/or regulator should also monitor these situations. (sub. 18, p. 3)

Assessment

The investment covenant mostly codifies what a prudent trustee could be expected to do under general trust law.[3] It could be argued that the investment covenant neither adds an additional layer of safety nor imposes unnecessary costs. On the other hand, the investment covenant may strengthen prudent management because:

- it provides the trustee with a clear statement of responsibilities which may assist their efficiency, simply because the 'tasks' have been spelt out;
- it provides greater assurance that an appropriate investment strategy is formulated, implemented and reviewed; and
- codification provides greater transparency and certainty with respect to what must be done by a trustee. As such, rights to civil action for loss or damage due to breach of the covenant may be more easy to establish.

The cost of complying with the investment covenant (such as documentation, time, and possibly paying for professional advice) may be greater than if the trustee executed its duties under general trust law. However, these costs do not appear to be much larger than they would otherwise be in a well run trust. Further, any such 'incremental' costs are likely to be small in comparison with the additional prudential benefits.

The possibility of insufficient diversification of investments by a minority of superannuation entities is, in the first instance, an enforcement matter rather than a weakness in the current law requiring change. The great majority of entities comply with the existing law and guidelines. APRA appears to have a clear idea of the type of entities that are not diversifying to the extent it considers prudent. This implies that if members' contributions are currently at undue risk, the quickest and most cost-effective remedy is likely to be immediate, direct interaction between APRA and the entities of concern. APRA acknowledged that this 'will inevitably involve APRA in fine judgement about whether certain assets or portfolios are appropriate, often while those assets are still performing satisfactorily' (sub. 36, p. 9). Changing

3 Similarly, other covenants under section 52 require the trustee, among other things, to: act honestly; exercise the degree, care, and diligence of an ordinary prudent person dealing with the property of another for whom the person felt morally bound to provide; and perform and exercise the duties and powers in the best interest of the beneficiaries.

a 'concentrated' portfolio to a diversified one may result in bringing to account book losses on assets which are over-represented in the portfolio.

Revision of guidelines on investment, as proposed by APRA, would be a complementary measure which should help to bring about a change in some trustees' approach to diversification.

6.4 Provisions defining annuities and pensions

The SIS legislation refers broadly to two kinds of retirement incomes streams — annuities and pensions.[4] An 'annuity' is defined as including a benefit provided by a life insurance company or a registered organisation, if the benefit arises under a contract which meets prescribed standards (sec. 10(1) and reg. 1.05(1)). A 'pension' is defined as including a benefit provided by a superannuation fund, where the benefit is provided under rules of the fund which meet prescribed standards (sec. 10(1) and reg. 1.06(1)).

The prescribed standards generally set out:

- conditions relating to the frequency of payments of the annuity or pension (which must be at least once a year);
- minimum and maximum payment amounts, where these are not defined;
- restrictions on return of capital, transfer or commutation (commutation is a partial or full conversion of an annuity or pension to a lump sum); and
- a prohibition on using the benefit for borrowings (part 1A of the Regulations).

These standards effectively mean that a number of different types of annuities and pensions are recognised under the SIS legislation (box 6.3). The Australian Retirement Income Streams Association Ltd (ARISA) considered that there are six types of annuities and four types of pensions (sub. 21, p. 1): 'complying' lifetime annuities and pensions, 'complying' life expectancy annuities and pensions, allocated annuities and pensions, fixed-term or lifetime 'non-complying' annuities and pensions, annuities with bonus payments, and mixed annuities. All these types of annuities and pensions attract varying degrees of special taxation and social security treatment. However, it is not clear to the Commission whether a retirement incomes stream that does not satisfy the standards would be prohibited under the SIS legislation.

4 As the legislation was enacted pursuant to the Commonwealth's Constitutional powers with respect to corporations and pensions (sec. 3(2)), it is not surprising to see references to 'pensions' and 'annuities'.

The provisions defining annuities and pensions address objectives inherent in the Government's retirement incomes policy, and social security and taxation policy more generally, rather than prudent management or prudential supervision concerns. This was noted by some participants such as ASFA (trans., p. 8) and Jacques Martin (trans., p. 168). According to the CCH Australia:

> The effect of the statutory definitions [within the SIS legislation of 'annuity' and 'pension'] is that all income streams which meet the prescribed minimum standards (including allocated annuities and allocated pensions) are taxable as annuities and pensions and may qualify as rebatable [eligible termination payment] annuities or rebatable superannuation pensions. (2001a, p. 7-500)

Box 6.3 **Some types of annuities and pensions covered under the SIS legislation**

'Complying' lifetime annuity or pension. An annuity or pension that is paid at least annually throughout the life of the main beneficiary (and the reversionary beneficiary if there is one). The size of the payment in a year is fixed and can only vary if specified in the contract/rules. Indexation is optional, and commutation is permitted in certain circumstances.

'Complying' life expectancy annuity or pension. An annuity or pension that is paid at least annually to the main beneficiary (or a reversionary beneficiary if there is one). The total amount of the payments in the first and subsequent years is fixed and can only vary to pay the superannuation contributions surcharge and in accordance with prescribed indexation limits. The annuity or pension can only be purchased on or after the beneficiary's age pension or service pension age. The annuity or pension is payable for a term equal to the beneficiary's life expectancy (where less than 15 years) or a term that is at least equal to 15 years.

Allocated annuity or pensions. An annuity or pension that is not a complying lifetime annuity or pension, or a complying life expectancy annuity or pension. The contract/rules do not fix the payment rate and basis for any variation. The payments are made at least annually. The payment amounts in a year (except in the case of a commutation) are subject to prescribed maximum and minimum limits.

Sources: CCH Australia (2001a, p. 7-540).

Assessment

Two basic concerns about the annuity and pension provisions were raised by participants.

The first concern expressed by ARISA was that the provisions restricted competition by:

- denying older retirees access to allocated income streams;

- restricting non-eligible termination payment income streams to guaranteed immediate annuity products; and
- restricting complying lifetime and life expectancy annuities and pensions to guaranteed products only, 'due to the requirement to ensure that income payments never decrease from one year to the next' (sub. 21, p. 4).

ARISA said that the third restriction:

> … results in life companies being the only effective providers of these products to the broader public. Even public offer superannuation funds that wish to offer such products are usually required to source the necessary income guarantees from a life company.
>
> … [it] also creates an illusion of safety for retirees. The income returns will be restricted compared to the potential returns from growth investments over a longer period of time. In addition, any attempt to change providers in the future may result in penalties (eg. if interest rates have risen), thus ensuring that retirees are locked in to existing products rather than being able to seek the best returns in a free and competitive market place. (sub. 21, p. 4)

ARISA proposed that a set of rules be established for all potential income stream providers based around 'preferred product characteristics' such as product type (for example, fixed term, lifetime or allocated), guaranteed term or non-guaranteed term, type of indexation (for example, none, fixed, variable or the consumer price index), residual capital value or nil residual capital value, and commutable or non-commutable (sub. 21, p. 5). It said:

> Overall the objective would be to establish one set of rules for all potential income stream providers based around preferred product characteristics from a regulatory perspective. This would ensure that the required 'product rules' do not depend on product names or type of provider (eg bank, life company, super fund etc). … streamlining the regulation of income stream products in this way also opens up the market to improved competition by ensuring that similar products can be offered under any structure (ie annuity or pension). It also greatly aids market development, by simplifying the current legislative framework involved with product development, reducing compliance costs in the process. (sub. 21, p. 5)

The second concern expressed by participants about the provisions relates to inconsistencies within them. ARISA said that, under one provision, all pensions other than complying lifetime pensions are limited to an amount determined by applying a prescribed factor, whereas under another provision complying life expectancy pensions cannot exceed the benefit that was payable immediately before the commutation (sub. 21, p. 2). William M Mercer said that while it is not necessary for lifetime pensions to be indexed, life expectancy pensions must be indexed. It also noted inconsistencies in the value to be placed on pensions for retirement benefit limit purposes in schedule 1B of the SIS Regulations, particularly where pension indexation is at the discretion of the trustee (sub. 8, p. 21).

It is difficult to determine, however, whether these limitations and inconsistencies about the annuity and pension provisions could be reduced without compromising the underlying retirement income policy objectives of the provisions. Alternatives to these provisions, such as that proposed above by ARISA, may well involve significant taxation and social security considerations which are outside the scope of this inquiry. At the draft report hearings, the Institute of Actuaries of Australia noted:

> ... allowing a broader range of pension and annuity products to be treated as complying pensions ... 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. (trans., p. 260)

Accordingly, the Commission is not in a position to issue a finding about or to recommend that further action be taken by the Government in respect of the annuity and pensions provisions.

6.5 Exemption of some public sector superannuation schemes

Certain Commonwealth, State and Territory public sector superannuation schemes are exempt from the SIS legislation.[5] These are listed in the legislation (schedule 1AA of the Regulations). The exempt schemes generally include schemes for the Governor-General, State Governors, judges, parliamentarians, the defence force, police, emergency services and other public sector employees.

There are an estimated 48 exempt schemes, compared with 18 public sector superannuation schemes which are subject to the SIS legislation (table 6.1).[6] The exempt schemes have over 1.7 million members and the schemes subject to the SIS legislation have over 2.8 million members (APRA 2001k, table 2a).[7] Of the exempt schemes, 25 are closed to new members and 23 are open.

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5 Public sector superannuation schemes are defined as schemes for the payment of superannuation, retirement or death benefits, established: under a Commonwealth, State or Territory law; or under the authority of the Commonwealth, State or Territory Government, or a municipal corporation, another local governing body or a public authority constituted a Commonwealth, State or Territory law (sec. 10(1)).

6 In some jurisdictions such as NSW, Victoria, the Northern Territory and Tasmania, public servants have fund choice and thus can be members of private sector funds regulated under the SIS legislation.

7 This data appear to represent member accounts and, thus, may over-estimate the numbers of members in exempt schemes and schemes subject to the SIS legislation.

The exempt schemes are treated as complying funds for income tax and superannuation guarantee purposes. They are subject to requirements imposed by the specific legislation (or policy) under which they are established, and to provisions enunciated in a Heads of Government Agreement between the Commonwealth Government and each of the State and Territory governments.

The Heads of Government Agreement recognises ‘substantial differences’ between the schemes and those in the private sector. The Agreement states:

> Public sector schemes often have complex benefit structures and are publicly accountable for their administrative effectiveness and efficiency and performance. They are controlled by legislative and other arrangements under State law, and are subject to substantial prudential controls imposed by State Governments. … These controls are extensive and subject the fund and schemes to a significant level of prudential control, and public and government scrutiny.

Table 6.1 **Public sector superannuation schemes[a]**

		Exempt schemes				
				Total		
Jurisdiction	*Schemes subject to the SIS legislation*	*Schemes for judges, governors and parliamentarians*	*Other schemes*	*Open schemes*	*Schemes*	*Members[b]*
Commonwealth	3	3	1	3	4	66 819
NSW	2	2	5	3	7	624 702
Victoria	0	1	2	2	3	177 929
Queensland	0	3	1	4	4	375 142
SA	6	3	9	4	12	192 830
WA	4	2	3	2	5	246 000
Tasmania	3	4	2	1	6	65 409
ACT	0	1	0	1	1	17
NT	0	3	3	3	6	11 100
Total	**18**	**22**	**26**	**23**	**48**	**1 759 948**

[a] The table generally covers schemes with assets. However, in some cases there are schemes (for example, for the Governor-General, State governors and judges) which involve merely a pension entitlement — there are neither contributions nor assets in these schemes. [b] This column is intended to reflect the number of current contributors, pensioners and individuals with preserved benefits in the scheme. The number may over-estimate actual members, as a member may hold more than one account.

Sources: Commonwealth, State and Territory governments.

The Agreement requires, however, that all governments use their ‘best endeavours’ to adhere to certain principles to ensure that exempted schemes are ‘treated fairly and equally with their private sector counterparts’ and that the Commonwealth Government’s retirement incomes policy objectives are met in respect of scheme benefits. The principles by and large reflect the SIS legislation (box 6.4).

Assessment

The exemption enables the governments concerned to avoid a number of difficulties which they would otherwise face in bringing certain public sector superannuation schemes into full compliance with the SIS legislation.

State and Territory government representatives indicated to the Commission that they generally espoused the continuation of the Heads of Government Agreement and the exemption of certain schemes from the SIS legislation. They cited several reasons, including sovereignty, continuation of certain existing member benefits, investment arrangements, while at the same time noting the strong prudent management and supervision arrangements applying to exempt State schemes.

Box 6.4 **Principles of the Heads of Government Agreement relating to public sector superannuation schemes**

- The superannuation funds must operate for the purpose of generating and providing genuine retirement benefits for members.
- The funds must operate within limits consistent with the SIS legislation with respect to the provision of loans and other financial assistance to members or their relatives.
- The schemes should provide adequate vesting standards to ensure that, on resignation before retirement, benefits are not diminished or lost.
- Benefits generated by schemes should not, as far as possible, be accessed before retirement.
- Vested benefits should be able to be rolled over from one fund to another.
- Accrued benefits must not be adversely affected by amendments to rules.
- Members must not be able to assign or mortgage away their benefits payable on retirement.
- Members must be represented on the governing bodies of superannuation funds.
- Appropriate and timely information is to be provided to both new and continuing members.
- The funds must be regularly audited.
- The trustees or board of a scheme must establish and maintain appropriate internal arrangements for dealing with queries and complaints.
- The relevant Commonwealth body supervising superannuation schemes should be provided with statistical information on the State's schemes.

Source: South Australian Government (sub. 31, pp. 11–12).

For example, the South Australian Government noted various difficulties in submitting its exempt schemes to the SIS legislation. (Some of these difficulties may also be relevant to the exempt schemes of other jurisdictions.) One difficulty relates to the nature of the member benefits. The Government said:

> … for political and industrial reasons it is simply not always possible to change … complex arrangements so as to bring [the structure of the South Australian schemes] more into line with scheme structures and standards in the private sector. … the differences between the structures … are in the scheme of things “minor”. However, in most cases a move to strictly conform with SIS would result in long standing options and rights being removed. … most if not all of these schemes were well established before the standards under the SIS Act were established. (sub. 31, p. 12)

Another difficulty apparently relates to the unfunded or partially funded nature of exempt schemes. For example, the South Australian Government was of the opinion that the SIS legislation would require that these schemes satisfy a ‘solvency test’ and contain sufficient assets to meet the payment of members accrued benefits (sub. 31, p. 13).

A final difficulty expressed by the South Australian Government is that its exempt schemes are ‘constitutionally protected’. The Government noted that they are structured so that assets (including member and employer contributions) are owned by the Crown and as such the ‘funds which underpin the schemes are exempt from taxation on employer contributions … and the fund’s investment earnings, by virtue of clause 114 of the Commonwealth Constitution’ (sub. 31, p. 8). Thus, making the schemes subject to the SIS legislation would have taxation consequences for the State.

At the same time, however, the exemption of public sector superannuation schemes leads to certain inconsistencies — particularly between members of the exempt schemes and members of superannuation entities currently subject to the SIS legislation. For example, there are schemes which permit members to obtain their benefits prior to the age of 55, the minimum age for the withdrawal of preserved benefits. Further, one scheme is more restrictive about commutation of a pension than the SIS legislation allows.

Such inconsistencies with the SIS legislation are likely to perpetuate where exempt schemes are open to new members. An estimated 23 exempt schemes are open to new members (table 6.1). Accordingly, it may be desirable that the current list of exempt schemes does not expand. Indeed, consideration should be given by governments as to whether open exempt schemes could be closed or made more consistent with the SIS legislation.

In the draft report, the Commission recommended that there should be no expansion of the current list of exempt public sector superannuation schemes. It said that consideration should be given by governments to the feasibility of closing exempt schemes which are open to new members and that any new schemes should be made subject to the SIS legislation.

In their responses to the draft report, some participants challenged this recommendation. ASFA considered that any final recommendation on these schemes should be made only after full investigation of the legal and constitutional issues involved:

> If the underlying reason that these schemes are listed in a schedule and not directly regulated by SIS is because of constitutional difficulties then the Commission's draft recommendation is in fact a proposed ban on Commonwealth, State and Territory Governments providing a corporate superannuation scheme for their employees. (sub. DR56, p. 7)

And the Government Employees Superannuation Board said the recommendation:

> … is not supported by any evidence of adverse impact on the Commonwealth's retirement income policy, or risk to members' benefits flowing from the exemption of public sector superannuation schemes from the SIS legislation. The paper recognises the high prudential standards imposed upon exempt public sector schemes, and that this standard is recognised in the existing Head of Government's agreement. No evidence is provided to indicate that this standard is less than it would be under full compliance with SIS. (sub. DR65, p. 1)

Jacques Martin suggested that:

> Rather than not expanding the current list of exempt schemes, or closing existing schemes to new members, consideration could be given to ensuring enhanced consistency with the SIS legislation by ensuring that the provisions enunciated in the Heads of Government Agreement more closely align with the SIS provisions. (sub. DR62, p. 20).

The Commission remains of the view that there are no compelling reasons why existing exempt schemes should remain open or why new schemes should not be subject to the legislation. There are already 18 public sector schemes — of which 15 are State schemes — subject to the SIS legislation. However, the Commission agrees that because of concerns about sovereignty, State and Territory governments may choose not to subject their schemes to Commonwealth legislation or to supervision or review by Commonwealth bodies such as APRA or the Superannuation Complaints Tribunal.

RECOMMENDATION 6.1

There should be no expansion of the current list of exempt public sector superannuation schemes. Consideration should be given by Commonwealth, State and Territory governments to the feasibility of closing exempt schemes which are open to new members and electing to make any new schemes subject to the SIS legislation.

6.6 Administration

Division of responsibilities

Responsibility for the administration of the specific parts of the SIS Act is outlined in the legislation itself (part 1, division 6). In general terms:

- ASIC is responsible for consumer protection and market integrity issues in relation to superannuation;
- APRA is responsible for prudential regulation; and
- the ATO is responsible for taxation aspects of superannuation, including compliance with the superannuation guarantee, regulation of self-managed superannuation funds (SMSFs), administration of the Lost Members Register and education about superannuation choice.

The division of responsibilities between APRA and ASIC applies not only to superannuation regulation but across the financial sector. The current structure of regulatory administration for the financial sector, established on 1 July 1998, is based on objectives, whereas the previous structure was based on institutions. It is 'designed to improve the competitiveness and efficiency of the Australian financial system while preserving its integrity, security and fairness' (Treasury 1998, p. 19).

Participants raised a number of concerns about the current roles and responsibilities of the three regulators in respect of superannuation. For example, the Australian Industry Group commented:

> The respective roles and responsibilities of the various regulators are particularly complex and confusing and certainly raise the potential for duplication, uncertainty and unnecessary cost. (sub. 6, p. 2)

Similarly, the AIST commented that 'there are multiple regulators, with different policy objectives, different agendas and differing approaches to regulation. The regulators do not appear to liaise very well' (sub. 19, part 2, p. 4).

ASFA was more specific:

> The division between the regulatory roles of APRA and ASIC is often difficult for superannuation fund trustees to work out. Both regulators carry out audit/review of funds. Both issue guidance notes/circulars on what they interpret legislation to require and therefore what they expect from trustees. … There is clearly a need for very close work between the two organisations in their review/audit functions and for any interpretations of general requirements for trustees developed and distributed by the regulators to be not just similar but identical. …
>
> There also appears to be a lack of certainty among the regulators as to the scope and extent of their individual powers and area of supervision. While in part this is a natural flow on from the establishment of the new regulatory arrangement, it is also because supervisory activities are conducted in isolation when a joint approach might be a more appropriate means of resolving uncertainties. (sub. 15, pp. 16–17)

Jacques Martin observed:

> The regulatory oversight of superannuation trusts is not as cost effective as it could be.
>
> While the roles and responsibilities of the three regulators are relatively clearly defined and consistent, there are issues which emanate from there being more than one regulator administering the same legislation, albeit different provisions. As the SIS legislation was conceived and drafted as one piece of legislation there are often common concepts, if not defined terms, in differing parts of the legislative regime.
>
> The arrangements can result in uncertainty when two or more regulators have developed a position with respect to a particular concept which, while it may fall clearly within the province of the provisions which they are administering, may touch upon a provision administered by another regulator. (sub. 24, p. 10)

Jacques Martin submitted that the regulators' costs could be reduced by improved cooperation and communication between the regulators, including shared intelligence and possibly participating in joint surveillance. Similarly, ASFA said:

> On many occasions independent reviews by the regulators cover similar ground and are reviewing common arrangements, particularly where the activities under review involve service providers. Better coordination of activities may prove beneficial to both regulators and the fund trustees. (sub. 15, p. 16)

Assessment

Any system involving multiple regulators may occasionally give rise to uncertainty, inconsistent approaches and possible duplication. There are three types of costs which may emanate from this. First, there are compliance costs, such as time and paperwork arising from reviews and audits by more than one regulator covering related issues and possible legal advice to clarify differing opinions expressed by different regulators. Second, the ultimate cost of uncertainty could be loss of the tax concession, as noted by ASFA:

> For service providers who are administering or advising both APRA and ATO supervised entities [small APRA funds and SMSFs] the differing interpretations are confusing, costly and have the potential to lead to errors resulting in breaches of the legislation and the prospect of a loss of complying status. (sub. 15, p. 17)

Third, pre-emptive enforcement action and action in respect of breaches may be compromised if the regulators are unclear about respective responsibilities.

It is understandable that in the early stages of a new division of responsibilities, costs arising from some administrative inefficiencies may be relatively high. It is likely that, with experience, they will be reduced as administrative responsibilities are clarified and industry becomes more familiar with them.

In recognition of the potential for overlap or gaps that may result from the new arrangements, the agencies have taken a number of steps to address coordination issues. For example, APRA, ASIC and the ATO have entered into memoranda of understanding. These memoranda outline a framework for cooperation in areas of common interest for the effective and efficient performance of financial sector regulatory functions. Their aim is to facilitate information sharing, reduce duplication and compliance costs, and achieve effective enforcement and compliance outcomes for both industry and the agencies. APRA and ASIC have carried out some joint reviews of supervised entities and expect to continue to do so where this practice can be useful. APRA and ASIC also conduct a number of joint liaison activities with industry bodies such as ASFA. In the case of small APRA funds and SMSFs, considerable work was done to ensure that the systems of both APRA and the ATO properly identify funds for which each regulator is responsible.

FINDING 6.7

It would be desirable that APRA and ASIC continue to improve coordination of their activities, such as site visits, with a view to reducing the additional costs which have arisen following changes in the administrative arrangements for the SIS Act.

Guidance material and general education

Since the SIS legislation was introduced, the Insurance and Superannuation Commission and APRA have issued considerable guidance and information material (table 6.2). Most information released has been in response to issues as they arise, apart from more regular publications such as the Superannuation Trustee Newsletter (up to 2000).

Circulars are the cornerstone of the guidance material. Parts of the SIS Act are provisions based upon general principles and circulars assist their interpretation (box 6.5).

Table 6.2 APRA superannuation releases

Year	*Circulars*	*Information statements*	*Information letters*	*Trustee newsletters*	*Media releases*	*Other APRA releases*	*Total*
1994	3	6	4	-	-	5	18
1995	7	-	5	1	8	3	24
1996	1	-	7	4	5	4	21
1997	2	-	4	4	-	-	10
1998	8	-	2	4	2	3	19
1999	3	-	-	4	4	12	23
2000	12	-	-	-	-	9	21
2001	2	-	-	-	-	-	2
Total	38	6	22	17	19	36	138

Source: CCH Australia and APRA (2001).

Box 6.5 Example of a circular to provide guidance on meeting a principle-based provision in the SIS Act

Section 52 (f) requires a trustee:

> To formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity …

APRA Circular II.D.1 provides guidance on what it means to formulate and give effect to an investment strategy. Specifically, it draws attention to the need to:

- formulate and document an investment objective;
- formulate a plan for making, holding and realising fund assets; and
- monitor investments, strategies, objectives and supporting systems.

In each case it gives further guidance, such as in respect of risk and return trade-offs, diversification, liquidity, expressing investment objectives as a range or benchmark for different asset classes, drawing attention to ensuring proper selection processes for investment managers and custodians, and factors to monitor (for example, tax reform and Y2K impacts).

A number of participants acknowledged the benefits of guidance material. For example, the Institute of Chartered Accountants in Australia commented:

> The Circulars issued by APRA generally reduce the costs of compliance as they provide clear guidance on the interpretation of SIS and enable processes to be put in place which ensure compliance. (sub. 9, p. 8)

Similarly, PricewaterhouseCoopers stated that the circulars ‘are extremely helpful in clarifying the application of the SIS Act and Regulations, which also helps manage compliance costs in the industry’ (sub. 14, p. 6)

Participants did express some concerns, however, about the circulars. For example, William M Mercer qualified its view of the benefits by drawing attention to the potential costs:

> In most cases, the circulars and other material are helpful rather than an additional cost — other than that there are hundreds more pages of material that trustees and administrators are expected to know. However, if the legislation had been clearly drafted in the first place, some of these circulars would have been unnecessary. Instead the circulars could have concentrated more on considering the principles involved and how they can be adapted to unusual situations.
>
> … there are some instances where we believe that the circulars are either clearly inconsistent with the underlying legislation … or have adopted an interpretation of the legislation that seems to involve a greater compliance requirement than that implied by the less precise legislation. (sub. 8, p. 12)

One example where William M Mercer considered APRA had misinterpreted the law was in relation to preservation treatment. It said that APRA Circular I.C.2:

> … completely reversed an interpretation on the treatment of preservation following retirement after 60. In our view the legislation clearly supports the previous interpretation and the new Circular appears to be in conflict with the legislation that has been in place for many years. In correspondence with APRA, we understand that APRA agree that the new Circular may not be consistent with the legislation. However, to date the Circular has not been corrected. (sub. 8, p. 23)

ASFA noted the potential benefits and costs of circulars and suggested a need for improved consultative mechanisms:

> The capacity of the regulators to issue circulars outlining their position on particular provisions has the capacity to provide certainty to the industry and thus reduce costs. However, inappropriate use of the process has the potential to create the opposite effect.
>
> In recent times APRA has issued circulars that express a point of view that many legal commentators believe is not supported by the law. APRA defended one circular by indicating an intention to seek amendment of the legislation to accord with the view expressed in the circular. As the circulars, of necessity, carry a disclaimer that they are non binding on the fund and APRA, fund trustees are placed in an unenviable position.

Should they seek independent legal advice? Should they follow the previously accepted view as outlined in earlier circulars and risk the wrath of the regulator? Should they follow the circular, the regulator's view and risk an adverse finding in a compliance audit or legal challenge from a member affected by the provision.

The above example establishes a clear case for a greater degree of consultation between the regulators and industry. (sub. 15, pp. 17–18)

Consultation by the regulator with industry raises the more general issue of the education and training role of the regulator(s). The Insurance and Superannuation Commission and APRA have sought to inform trustees of their responsibilities and to reduce information gaps, by various methods. This has been an important part of their work. When developing the SIS Act, the Insurance and Superannuation Commission was provided with resources to organise and present seminars, and to maintain contact with funds, industry associations and education institutions to determine requirements for education of fund members, trustees and allied professionals (Dawkins 1992, p. 5). As part of this inquiry, the AIST called for more education work by APRA:

AIST proposes that APRA establish an ongoing partnership with AIST for the purpose of providing trustees with accessible, up to date information on regulatory matters. …

AIST strongly advocates more regular participation in trustee education by the regulatory bodies, especially APRA.

This could be achieved by the formation of a formal partnership between the regulators, particularly APRA and AIST. (sub. 19, pp. 3–5).

Assessment

The benefits of circulars are three-fold. First, circulars enhance prudential safety by guiding trustees towards sound practice. For example, APRA intends to revise its advice to trustees regarding investment diversification. Second, circulars potentially can reduce the compliance costs of trustees by clarifying the intent of the regulatory requirements. Third, circulars can be used to respond quickly and flexibly to changes in industry circumstances.

On the other hand, each circular involves at least some familiarisation cost, including possible legal advice. Circulars may also result in operational compliance costs if they change the way duties are currently discharged. There is also the potential for some circulars to confuse or give rise to uncertainty.

While circulars are generally a guidance document, some may be more 'directive' than others. In such cases, the circular may be of a quasi-regulatory nature — quasi-regulations are described as 'those rules, instruments and standards where government influences business to comply, but which do not form part of explicit government regulation' (PC 2000, p. 8). That is, while circulars carry an extensive disclaimer saying they have no legal effect, there is also a clear expectation that trustees will follow the guidelines.[8] Trustees are then in the position of feeling compelled to comply even if they believe the guidance material is not a cost-effective way of achieving the regulatory objective.

To minimise any potential costs associated with circulars, it is important that mechanisms for development of circulars and consultations are effective and efficient. This is particularly important if the circular is of a quasi-regulatory nature. Where this is the case, APRA is required, under the Commonwealth's regulatory assessment processes, to prepare a regulatory impact statement.[9] This statement includes an analysis of the objectives, benefits and costs of the approach described in a circular. Importantly, preparation of a regulatory impact statement requires appropriate consultation and the acknowledgement of the outcome of the consultation process. This process should help to minimise concerns about circulars.

The need to ensure that appropriate mechanisms are in place for the development of guidance material which may be quasi-regulatory assumes more importance the greater the reliance on guidance material for meeting regulatory objectives. For example, where legislation is structured as a three-tiered model[10] (such as the *Banking Act 1959* and the *General Insurance Reform Act 2001*) guidance material may 'substitute' for directives in the Act or regulations.

8 A Circular is not exhaustive in its coverage of rights or obligations under any law, it is based on APRA's interpretation of the relevant legislation in respect of the superannuation entities for which it is the regulator and, it has no legal status or legal effect whatsoever, a circular may be affected by changes to legislation; APRA accepts no responsibility for the accuracy, completeness or currency of the material included in a Circular; users of circulars are encouraged to obtain professional advice on the relevant legislation and to exercise their own skill and care in relation to any material contained in a circular; and APRA disclaims any and all liability and responsibility for any loss or damages arising out of any use of, or reliance on the Circular (CCH Australia and APRA 2001, p. 2002).

9 This is consistent with the requirement for ASIC to prepare regulatory impact statements for policy statements that are of a quasi-regulatory nature. In 1999-2000, Commonwealth bodies prepared 24 regulatory impact statements for quasi-regulations, 15 of which were prepared by ASIC (PC 2000, pp. 8, 32).

10 Consisting of an Act containing high order principles, a second tier of disallowable subordinate instruments relating to prudential standards, and a third tier of guidance notes setting out how the regulatory standards are to be applied in practice.

On the matter of the educative role of the regulators, the Commission considers that the superannuation fund should pay for (ongoing) training and education of trustees. Consistent with their sole responsibility under the SIS Act, trustees must ensure that their knowledge and skills are of sufficient standard to enable them to execute their duties satisfactorily. Educational material and courses are available from many sources including industry associations, professional bodies and educational institutions. APRA contributes in many different ways to informing and educating trustees, both of its own initiative (for example, its interpretations of legislation) and in conjunction with the industry. At a minimum, APRA has a responsibility to explain its surveillance and enforcement role and approach, but should not be responsible for funding trustee training and skill acquisition.

7 Modifications to the SIS legislation

The Commission has identified for consideration four options involving modifications to the SIS legislation which have some potential to enable its prudent management and prudential supervision objectives to be met more cost-effectively. Option 1, by improving specific areas within the legislation, would reduce compliance costs, remove restrictions on competition and increase the effectiveness of some requirements. Option 2 would enhance prudent management and prudential supervision through a licensing arrangement for *superannuation trustee entities*. Option 3 would remove the need for life insurance companies, which comply with the Life Insurance Act, and some retail investment providers, which comply with the Managed Investments Act, to also meet corresponding requirements of the SIS legislation. Option 4 would change the overall structure of the legislation. Options 3 and 4, while advantageous in some respects, involve a number of difficulties. The Commission's preferred approach consists of the combination of options 1 and 2.

The Commission is required by its terms of reference to consider relevant options for the SIS legislation.

In undertaking this task, the Commission is cognisant of the generally held view of participants that, by and large, the legislation achieves its prudent management objective. Participants supported its uniform requirements which accommodate a diverse range of providers of superannuation products and its approach to preventing problems arising in superannuation entities. They noted that there had been relatively few cases of failure as a result of weaknesses in the legal framework — although such deficiencies can involve substantial costs for the members of superannuation entities concerned.

Nonetheless, it is important to consider whether it is possible to improve the cost-effectiveness of the legislation. Are there options which would achieve the legislation's prudent management and prudential supervision objectives — that part of the Act under review — at as little cost to the community's resources as possible? An important purpose of such options should be that, where there is strong competition, they result in benefits to members of superannuation entities, as a result of lower compliance costs producing some gains in the entities' net income.

Improving the cost-effectiveness of the legislation could involve:

- pursuing the objectives of the legislation more effectively (or enlarging the legislation's benefits) — for example, by ensuring that the legislation targets better the relevant prudent management and prudential supervision problems associated with superannuation entities; and
- reducing compliance and other costs imposed on superannuation entities and their members — for example, by reducing the complexity and prescription of the legislation, reducing legislative duplication, and increasing competition within the superannuation industry.

The Commission has identified four options — largely derived from participants' suggestions — that could help to improve the cost-effectiveness of the legislation. The options are:

- improve specific areas of the legislation which have been identified in chapters 4 and 5 as warranting reform — option 1;
- enhance prudent management and prudential supervision through an effective licensing arrangement — option 2;
- remove the need for life insurance companies which comply with the *Life Insurance Act 1995*, and some retail investment providers which comply with the *Managed Investments Act 1998* (MIA), to meet corresponding requirements of the SIS legislation — option 3; and
- revise the overall structure of the legislation — option 4.

Options 2 to 4 would involve more significant changes to the SIS legislation (and its administration) than option 1. They might address more comprehensively such matters as the legislation's complexity and prescriptiveness, its effectiveness in meeting its prudent management and prudential supervision objectives, and legislative duplication. Although options 2 and 3 could be implemented together with option 1, option 4 is distinct and would involve more fundamental change.

In examining the four options, the Commission is mindful that the community expects a high standard of prudent management and prudential supervision of superannuation entities. Some concerns have been expressed about the apparent losses incurred by some superannuation entities including the Employees Productivity Award Superannuation Fund, the Corrections Corporation Staff Superannuation Fund and around 500 small APRA funds and several other small public offer entities managed by Commercial Nominees of Australia Pty Ltd.

Accordingly, the Commission has been conscious of the need to avoid proposing options which would weaken the legislative framework for the prudent management and prudential supervision of superannuation entities. One such option would be to remove the legislation and rely on ordinary trust law and the Corporations Law. The Commission does not consider that such an approach would be tenable. The elements of compulsion and tax-induced encouragement to make superannuation contributions mean that legislation is needed for the prudent management and prudential supervision of superannuation entities and their members' interests.

The Commission notes that some of the options, particularly options 3 and 4, could mean that superannuation entities would be subject to more than one piece of legislation than hitherto. Industry associations and some other participants attached considerable importance to having all legal requirements on superannuation entities within the SIS Act. However, the passage of the *Financial Services Reform Act 2001* (FSR Act) — which will lead to the transfer of the consumer protection aspects of the SIS legislation to the Corporations Law — implies that an 'all in one place' approach to the regulation of superannuation entities no longer applies.

7.1 Option 1 — improve specific areas of the legislation

This option consists of amending provisions in the SIS legislation, or APRA's interpretation of those provisions, which were identified in chapters 4 and 5 as unwarranted restrictions on competition or imposing significant compliance costs. The Commission's analysis suggests that reducing the complexity and prescriptiveness of the legislation — the main cause of additional compliance costs — is likely to bring the greatest benefits to members of superannuation entities and the wider community, by meeting the legislation's objectives more effectively. In comparison, there were relatively few unwarranted restrictions on competition and ineffective prudential requirements.

In the draft report, the Commission proposed the following amendments to the legislation:

- simplification of certain requirements governing the operations of superannuation entities which were found by the Commission to be imposing significant compliance costs, including:
  - age and employment requirements governing contributor status and compulsory cashing of benefits;
  - restrictions on access to (or transfer of) superannuation benefits of bona fide non-resident short-term employees;
  - requirements governing risk management statements to accompany the use of derivatives; and

- requirements for actuarial certificates;

- examination of possible avenues for increasing competition amongst providers of services to superannuation entities through APRA reviews of whether it is necessary to confine:
  - the conduct and authorisation of a compliance audit to an approved financial auditor; and
  - certain actuarial tasks in respect of accumulation funds to Members or Fellows of the Institute of Actuaries of Australia; and
- enhancement of the prudent management of superannuation entities managed by approved trustees by:
  - requiring all approved trustees to hold minimum amounts of net tangible assets (or approved guarantee or combination thereof) regardless of their custodial arrangements; and
  - revising the operating capital requirements for approved trustees so that they represent a specified proportion of their operating costs.

In their responses to the draft report, many participants supported the first group of improvements, particularly the simplification of age and employment requirements, and considered these should be accorded the highest priority. The Commission has also given further consideration, in chapter 5, to other requirements governing the operations of superannuation entities and is now of the view that this group of improvements should be expanded to include amendments to certain small account and lost member requirements.

Participants were mixed in their support for the second group of improvements — which involved reviewing some minor restrictions on competition — and also generally opposed the third group of improvements — which involved strengthening the net tangible asset and operating capital requirements applying to approved trustees. The Commission reviewed participants' concerns in chapter 4 and is of the view that the second group of improvements to the legislation identified in the draft report should remain unchanged, but that the third group of improvements should now consist of:

  - requiring all approved trustees, which use an external custodian, to hold net tangible assets (or approved guarantee or combination thereof) equivalent to a proportion of assets under management, subject to specified minimum and maximum amounts in a manner similar to that required under the MIA. Approved trustees which do no use an external custodian would continue to be required to have $5 million net tangible assets (or equivalent) in their own right;

- revising the operating capital requirements for approved trustees to ensure that they have sufficient liquidity, with the requirement being cast in terms similar to that required of responsible entities under the MIA; and
- requiring all trustees of APRA-regulated superannuation entities, not just approved trustees, to have a risk management strategy which would be approved by APRA and audited annually.

RECOMMENDATION 7.1

The SIS legislation should be amended to simplify certain complex requirements which impose significant compliance costs, to increase competition amongst providers of certain services to superannuation entities, and to enhance the effectiveness of capital adequacy and other requirements imposed on trustees. Specific proposals for change are contained in the recommendations given above and in chapters 4 and 5.

7.2 Option 2 — enhance the licensing of superannuation entities

Compared with other parts of the financial sector, relatively few entry requirements are imposed on superannuation entities, or their trustees — apart from public offer entities and small APRA funds for which there are 'approved trustee' requirements — in respect of their prudent management role. For an entity to become a regulated superannuation fund under the SIS legislation, for example, a trustee need only complete a form electing that the legislation is to apply to the fund; no other requirements, such as on capacity or competence of the trustee to manage the fund, are imposed before the fund commences operations.

It was suggested to the Commission by APRA that the prudent management and prudential supervision objectives of the legislation could be better served in respect of superannuation entities by a strengthened licensing arrangement.[1] APRA noted that 'in no other part of the prudentially regulated financial sector are entities or persons permitted to accept funds from the public without a formal licensing procedure' (sub 36, p. 8).

APRA also drew attention to problems which it saw relating to funds with and without approved trustees, particularly a large number of small funds managed by approved trustees as well as 1800 small corporate funds, each having less than

1 Only 'legal persons' such as individuals or corporations are able to be licensed. Superannuation entities, however, are not legal persons. Hence, the phrase 'licensing of superannuation entities' is used in an approximate sense.

$5 million in assets (sub 36, p. 4 and box 7.1). The trustees of the latter group of funds are comprised of individuals subject only to the disqualified person test and equal representation rules.

Finally, APRA noted that a licensing arrangement would help it identify more satisfactorily the population of active and inactive superannuation entities:

> Formal licensing arrangements … have the … practical benefit of allowing the regulator to accurately keep track of the regulated population. Without a clear licensing regime, there is no way of knowing with any certainty which entities are accepting superannuation funds. This poses a significant threat to fund members and needs to be addressed at the earliest opportunity. (sub 36, p. 8)

Box 7.1 **Problems in small corporate funds**

APRA drew attention to problems relating to 1800 small corporate funds, each having less than $5 million in assets:

> Many of these are well managed with active trustee (employer and employee representative) involvement. Nevertheless, … where problems have been detected in the superannuation sector they tend to be concentrated in this area. Where serious problems occur, the financial implications for affected fund members involved can be devastating. Typical problems encountered in these funds include:
>
> - Non-arm's length transactions and poor investment decisions resulting often in large capital losses. Frequently, problems can flow from a failure to develop and implement a proper investment strategy in accordance with legislation;
> - Concentration of assets and inadequate procedures for securing the fund's interest in holdings;
> - Delays in remitting contributions (Superannuation Guarantee, additional employer contributions, voluntary and salary sacrifice contributions);
> - Problems with systems capability and capacity; and
> - Trustee/directors' use of fund assets for their own benefit. (sub. 36, pp. 4–5)

The following are three recent examples of small corporate funds which have experienced some of the problems mentioned by APRA.

Example 1: Wes Lofts (Aust) Superannuation Fund
The Wes Lofts (Aust) Superannuation Fund is a corporate fund with about 50 members and total assets of $1.7 million as at 30 June 2001. Of that amount, about $690 000 had been lent back to the employer sponsor or invested in an associated unit trust.

(Continued next page)

Box 7.1 **(continued)**

The trustee had also entered into a scheme to reduce artificially the level of the Fund's in-house assets. APRA took court action against the directors of Wes Lofts Superannuation Pty Ltd, which was the trustee of the fund, for contravening the in-house asset rules within the SIS Act. The rules prohibit a superannuation fund from investing more than 5 per cent of the fund's assets in an employer sponsor. They are designed to protect members from losing a large part of their retirement savings in the event that the employer fails. The Federal Court issued orders against several of the trustee directors, declaring that they breached the in-house asset rules. One consequence was that the trustee directors became disqualified persons and were thus permanently prohibited from holding the position of superannuation fund trustee, investment manager or custodian. The fund continues to be operational.

Example 2: Corrections Corporation Staff Superannuation Fund

This corporate fund had more than 100 members and assets of less than $5 million. The corporate trustee had shifted its investment strategy towards high risk investments. Members were informed of this change in strategy at the time. The new strategy involved investment of a large proportion of the fund's assets in a commercial property. The employer sponsor, Corrections Corporation, lost a significant part of its business at the end of 2000. As a result, the corporate trustee had to liquidate most of the fund's assets to pay out staff who were leaving. The liquidation resulted in the commercial property being sold at a discount on its book value. The realisation of the asset meant that the fund posted a negative return of 23 per cent for the year to December 2000. The fund had been wound up and all member benefits paid out or transferred to other funds. As part of this process, the value of the member benefits was reduced. APRA commissioned a review of the fund by an independent accounting firm to confirm that there were no breaches of the SIS Act. The review found that there was no impropriety or fraud and that the investment strategy had been disclosed to fund members.

Example 3: Fund X

Fund X is a corporate fund with more than 100 members and less than $5 million in assets. APRA had a concern that a contribution received by the corporate trustee on behalf of the employer sponsor, which is part of a group of related companies controlled by company A, was not properly secured by the corporate trustee and, further, that the value of the contribution was smaller than the reported value. The contribution to the fund appears to have been directed by the controlling company of the group, company A, which secured the contribution from another company (company B) within the group. Both the employer sponsor and company B are now subject to liquidation proceedings. It is likely that the liquidator of company B will seek to recover the contribution from the fund. APRA has replaced the corporate trustee and has appointed an inspector to investigate the activities of the fund.

Sources: APRA (2001b; 2001c).

In the draft report, the Commission considered that, on balance, the careful design and implementation of a licensing arrangement would have merit. It took the view that such an arrangement would help to overcome perceived weaknesses in the present entry requirements contained in the SIS legislation. The Commission saw this proposal as a useful addition to the improvements suggested in option 1.

It said that although the details of such an arrangement would need to be developed carefully and may require amendments to the legislation, it could involve the following features:

- existing and newly created superannuation entities, other than self-managed superannuation funds (SMSFs), must be licensed by APRA if they are to be regulated under the SIS legislation and be eligible for special taxation treatment;
- the application for a licence must be made by the trustee(s) of the entity;
- APRA must issue a licence once certain specific conditions are satisfied by the trustee(s);
- periodic licence renewal (to ensure that entity continues to meet the licence conditions); and
- provisions for licence revocation (for example, if the entity fails to comply with the licence conditions or other requirements of the legislation).

Furthermore it said that the licence conditions could require, for example, that the trustee(s):

- meet certain requirements regarding their capacity to manage the entity;
- ensure the entity has certain minimum operating capital;
- provide an investment strategy; and
- use an independent auditor as well as an ASIC-approved dispute resolution body.

Such conditions — which were not intended by the Commission to be onerous, but reflective of ‘best practice’ — could vary according to the nature of the superannuation entity. For example, in relation to conditions applying to trustee capacity, individuals seeking to be trustees of employer-sponsored funds would need to satisfy a certain level of specified experience and qualifications. The conditions relating to corporations seeking to be trustees of public offer funds and small APRA funds could incorporate existing approved trustee requirements.

In reaching its view, the Commission considered that the enhancement of prudent management and prudential supervision outweigh the potential disadvantages of this option.

One potential disadvantage is that the option could reduce the number of smaller corporate funds with possible implications for competition within the industry and for the level of fees paid by members. This may occur because of potentially higher compliance costs imposed by the licensing arrangement, including the cost of capital. As a result, employer sponsors may seek to transfer management of their funds to larger entities, such as retail and industry funds. Such a response, however, could lead to greater cost-efficiencies being achieved within the industry if it reduced the incidence of problems identified by APRA and had no undue effect on other entities. According to the Association of Superannuation Funds of Australia's (ASFA's) recent cost survey, the cost structures of superannuation entities appear to be characterised by economies of scale. Such gains in cost-efficiencies could offer benefits to members in the form of a wider range of services and/or lower administration fees.

Another potential disadvantage is that a licence condition governing trustee capacity could be set too stringently. If this were the case, it would deter the entry of capable individuals seeking to be trustees. This possibility could be mitigated by the careful identification of a minimum level of qualifications and experience. Such a minimum level might equate to a certificate demonstrating the successful participation of an individual in an APRA-approved training program.

Participants' responses and the Commission's assessment

Although some participants such as the ACTU and the Trustee Corporations Association of Australia provided some support for the option, many expressed concerns or raised issues about it. These concerns and issues can be broadly grouped as follows:

- there is no valid case for a licensing arrangement;
- there would be adverse effects on competition;
- more effective alternatives exist;
- certain licence conditions would be ineffective;
- there would be overlap with the licensing regime contained in the FSR Act; and
- there is a need for better information.

No valid case for a licensing arrangement

A general concern about the option is that the case for a licensing arrangement has not been substantiated. Most participants who expressed this concern assumed that the main basis for the option is to address the problems arising in corporate funds.

For example, at the draft report hearings, the Small Independent Superannuation Funds Association Ltd said:

> … 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 … [is that] there is insufficient data in the market place in respect of the composition or make-up of those funds to support the perceived need for 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. (trans., p. 294)

The case for a licensing arrangement rests on a number of grounds. These include:

- a risk of loss of contributions;
- ensuring that standards of capacity and competence for superannuation entities are satisfied before the commencement of, and during, operations;
- the existence of licensing arrangements for the prudent management and prudential supervision of other financial institutions such as banks, life and general insurance companies;
- prudent management problems in certain superannuation entities, particularly small funds managed by approved trustees as well as small corporate funds; and
- the current limited ability of APRA to monitor the existing population of superannuation entities effectively.

The Commission considers that the first three grounds are the most compelling. Although existing requirements within the SIS legislation address these grounds to some extent, the setting of standards for, and the vetting of, superannuation entities and their trustees prior to their commencement of operations can further reduce the risks to a more acceptable level from the perspective of the wider community and the members of the entities.

The remaining grounds are not as convincing. As discussed below, a licensing arrangement is not the only means of addressing problems in corporate funds and the current difficulties that APRA has in monitoring the existing population of superannuation entities. More effective and targeted strategies can be conceived.

Adverse effects on competition

A number of participants expressed concerns about the adverse effects of the option on competition within the industry, particularly with respect to corporate funds. For example, the Institute of Actuaries of Australia believed that:

> … the recent trends to close small corporate funds and wind them into large industry funds and master trusts would dramatically accelerate. We find it difficult to see how this is in the interests of competition policy. It could lead to higher fees and hence lower retirement benefits. (sub DR55, p. 4)

However, at the draft report hearings, the Institute qualified this by stating that this impact 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 … corporate and so-called not-for-profit funds. (trans., p. 244)

And the Corporate Super Association said:

> Capital Adequacy Requirements and Licensing will unfairly restrict competition by diminishing the number of medium to large Corporations sponsoring not-for-profit provision of superannuation and as a consequence distorting the market in favour of the commercially driven provision of super. (sub DR64, p. 3)

The Commission acknowledges that a licensing arrangement would create an incentive for some employer sponsors to transfer corporate funds to industry and retail funds. It is of the view, however, that these effects, and the potential costs which they might induce (such as higher fees), are likely to be small in comparison with the added benefits to the prudent management and prudential supervision of the superannuation entities. As noted above, fund members could benefit from cost-efficiencies associated with larger scale operations. Moreover, the Commission is proposing licence conditions that would not be onerous.

More effective alternatives exist

A number of participants suggested ways other than a licensing arrangement for dealing with specific problems of prudent management and prudential supervision.

In relation to problems in small corporate funds, ASFA said:

> … it's as much about finding the appropriate remedy for the problem. If … [this problem] 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? … licensing or capital adequacy for all APRA regulated funds appears to be a bit of … a sledge hammer and walnut situation. (trans., pp. 275–6)

Indeed, a targeted solution to the problems in small corporate funds was proposed by several participants. The Corporate Super Association said:

> Concerns about better safeguarding Australians' retirement benefits would be more effectively addressed through focussing on the two critical areas of potential failure —

Administrative Failure and Investment Failure — by tightening Regulations for not for profit super funds broadly in the following manner:

1. Funds whose assets fall below a certain quantum should be obliged to have their diversified investment strategy delivered through pooled investment vehicles managed by professional Investment Managers, which are properly licensed and which have appropriate capital adequacy.
2. In House investment should generally be abolished with some clear exceptions including such as where such an event occurs through external investment managers' objective investment decisions.
3. "Threshold tests" of appropriate systems, resources and capabilities requirements for each Fund should be introduced. (sub DR64, p. 3)

The Small Independent Superannuation Funds of Australia suggested that only entities with members at arm's length to each other should be subject to a high level of prudential supervision:

> … 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. …. 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 … necessary. The risk isn't there. (trans., p. 303)

Some participants made suggestions in respect of the difficulties APRA has had in monitoring the existing population of superannuation entities and trustees effectively. ASFA said:

> We support APRA having sufficient and appropriate information on funds to effectively and efficiently regulate them. However we believe licensing would be a blunt instrument to achieve this end. … Other means of capturing the necessary information should be considered. For instance, all non-SMSF funds are required to notify APRA within 60 days of being established that they wish to become a complying fund. This may be the point at which APRA could collect the necessary information to assist prudential supervision. This would create a better 'registration' process. (sub DR56, p. 8)

And Jacques Martin Industry Funds Administration Pty Ltd (Jacques Martin) noted:

> What is required in order for APRA to identify more satisfactorily the population of active and inactive superannuation entities is an improvement in the process of lodging annual returns with APRA. Simply knowing the number of licensed drivers provides no information about road usage or the number of drivers who actually drive. (sub DR62, p. 24)

The Commission agrees in principle that specific problems experienced by some classes of superannuation entity may warrant more targeted solutions. It considers that some of the suggestions of participants have merit and deserve further attention by APRA. However, they are not seen as a substitute for a licensing arrangement.

Licence conditions

Several participants expressed concerns about some of the licence conditions suggested in the draft report.

Trustee capacity

Some participants expressed concerns about the application to individuals of a condition governing trustee capacity. Jacques Martin said:

> Imposing conditions as to trustee capacity … in practice may mean assessing individual directors and officers who may in practice have little or no say in the management of the fund or who may cease to act in their capacity the day after the licence is granted. (sub DR62, p. 23)

And the ACTU said:

> There should not be a requirement for individual trustees or directors of corporate trustees to personally hold specific qualifications, although training should be encouraged as part of the normal responsibility of persons acting in a trustee capacity. (sub DR66, p. 2)

The Institute of Actuaries of Australia said:

> We are particularly concerned at the apparent suggestion … that individuals (not the trustee group as a whole) would need to apply for a licence. We would be less opposed to a requirement that individuals undergo some accredited training and that any licensing requirement focus on the competencies of trustee boards in aggregate not on individuals. (sub DR55, p. 5)

The Commission understands that there is provision under the FSR legislation for a group of individual trustees to apply for a financial services licence, subject to assessments as to each trustee's qualifications and experience. It continues to support a licence condition governing trustee capacity for prudent management and prudential supervision purposes, but considers that there should be consistency with the FSR licensing regime. In particular, it considers that the trustee entity should be licensed, with conditions imposed governing the competence of individuals.

Minimum operating capital

Numerous concerns were raised about imposing a licence condition to ensure that the entity has certain minimum operating capital. These concerns were reviewed in chapter 4. As a result of that review, the Commission recommended that the operating capital requirements for all approved trustees should be revised so as to ensure that they have sufficient liquidity and that all trustees, not just approved trustees, have an APRA-approved strategy in place for managing risks. An APRA-approved risk management strategy could be incorporated under this option as a licence condition (see below).

Investment strategy

Jacques Martin raised a concern about a licence condition to have an investment strategy:

> Any requirement to provide an investment strategy will see the development of 'formulated' strategies which will be 'trotted out' with the risk that there may be little real understanding or appreciation of the factors which must be considered. Of greater importance than the formulation of an investment strategy is ensuring that the trustee adheres to the strategy in setting its investment mandates or when making direct investments and ensures that investment managers observe their mandates. (sub DR62, p. 24)

The Commission notes that trustees are required to have an investment strategy under the SIS legislation; a licence condition in that regard should not be an added burden for trustees. Although there is a risk that the intention of such a condition could be thwarted if some trustees merely adopted a formulated strategy, most trustees could be expected to prepare an appropriate strategy diligently.

However, the Commission is of the view that there may be benefit in having a licence condition requiring trustees to submit a general risk management strategy to APRA for approval. Such a general strategy could document the trustees' approach to identifying, assessing and managing specific risks relating to the entity and could incorporate existing investment strategies and risk management statements. Trustees' commitments to, and compliance with, a risk management strategy licence condition should be subject to regular monitoring and review such as through annual returns and compliance audits.

Interaction with the FSR licensing regime

Another general concern about the licensing arrangement is that it would go beyond the requirements of the FSR legislation with respect to licensing of providers of financial services (box 7.2).

The Commission agrees that the option would overlap with the FSR licensing regime in that trustees of funds which do not operate on a public offer basis would need an APRA licence. Trustees of public offer funds will be required under the FSR Act to have a financial services licence to deal (for example, issue superannuation interests) as well as to advise. Trustees of non-public offer funds will not be required to have a licence to deal, although they will be required to have a licence to advise.

Box 7.2 **Financial Services Reform legislation**

The FSR Act introduces a new chapter 7 into the Corporations Law. It was enacted on 23 August 2001 and will commence on 11 March 2002, with a two year transitional period. ASIC will have administrative responsibility for the new legislation. The FSR Act deals with product disclosure, licensing and conduct of financial services providers, licensing of financial markets, and licensing of clearing and settlement facilities. The Act's provisions are extensive and will replace many provisions of the SIS legislation. Regulations under the Act have also been issued, and ASIC has proposed a large number of policy papers.

Licensing of providers of financial services

The Act provides a single licensing regime applying to all persons providing a financial service. 'Financial service' includes 'financial product advice', dealings in or making a market for a financial product or selling one's own products, operating a managed investment scheme, or providing a custodial or depository service. The general obligations of licensees are set out in section 912A. Examples of the conduct standards which may be imposed on licensees include providing financial services in a competent or honest way, complying with any licence conditions imposed by ASIC, complying with obligations in respect of handling of client funds, maintaining competence, skills and experience to provide financial services, and having internal and external dispute resolution procedures that are approved by ASIC.

Exemptions applying to trustees of superannuation entities

Trustees of superannuation entities will be exempt from holding a financial services licence if they:

- are trustees of SMSFs (sec. 911A(2));
- deal in a financial product in the capacity of a trustee of a non-public offer superannuation entity (reg. 7.6.01(1)(a));
- deal in a financial product in the capacity of a trustee of a pooled superannuation trust in certain circumstances (reg.7.6.01(1)(b)(c)(d)); and
- provide a financial service that consists only of the provision of factual information (that is, not advice) to a member or prospective member of a superannuation fund (reg.7.6.01(1)(l)).

However, this regulatory framework would be an inevitable consequence of the Financial Sector Inquiry reforms, which promote a functional, rather than an institutional or product-based, approach to regulating the financial sector. The FSR licensing regime seeks to address consumer protection objectives, whereas the Commission's licensing option would seek to address prudent management and prudential supervision objectives. That said, the contribution the option would make to regulatory overlap could be reduced by ensuring that it and the FSR licensing regime, particularly in relation to the capacity of individual trustee/directors, were as consistent as possible.

Better information needed

The need for better information from annual returns about the entities that APRA supervises, particularly of corporate funds, was identified by participants as important for prudent management and prudential supervision. At the public hearings on the draft report, ASFA said:

> … 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. (trans., p. 275)

Having reviewed the annual return form, the Commission considers that there is scope for APRA to collect information more relevant to its prudential supervision and to the prudent management of superannuation entities by trustees. In particular, the inclusion of questions regarding the composition of an entity's assets and whether there is an arm's length relationship between trustees and the investments they made would help APRA to identify whether entities were being managed by their trustees in a prudent manner.

Overall assessment

After reviewing participants' responses to the option, the Commission remains of the view that the introduction of a licensing arrangement would enhance the prudent management and prudential supervision of superannuation entities and complement the measures contained in option 1. In particular, it could facilitate the recommended requirement for all trustees to prepare risk management strategies for funds regulated by APRA.

However, the Commission acknowledges that a licensing arrangement should not be relied upon as the sole means of seeking the prudent management and prudential supervision of superannuation entities. For example, APRA could make better use of its investigation and enforcement powers to deal with identified problems. The Commission also considers that some of the suggestions put forward by participants appear worthwhile. These are that the present numerical limit which defines small APRA funds should be reconsidered with a view to removing from the small APRA fund category funds which are for all practical purposes SMSFs, and that APRA collect information which would be more useful for prudential supervision.

RECOMMENDATION 7.2

The SIS legislation should be amended to require that trustees of superannuation entities be licensed by the Australian Prudential Regulation Authority subject to specific conditions pertaining to such matters as trustee capacity and the provision of a risk management strategy. The Government and the Australian Prudential Regulation Authority should consult widely on the details of such a licensing arrangement.

7.3 Option 3 — remove duplication of compliance

This option seeks to reduce legislative duplication by removing the need for certain retail investment providers which comply with the MIA, and life insurance companies which comply with the Life Insurance Act, to comply also with corresponding requirements — particularly, governance requirements — under the SIS Act.

Responsible entities under the Managed Investments Act

Duplication between the SIS Act and the MIA (which is part of the Corporations Law and administered solely by ASIC) in relation to retail investment products — and, thus, unnecessary compliance costs — was a matter raised by the Investment and Financial Services Association (IFSA). It said:

> Retail investment fund managers must run both schemes concurrently to offer products in the retail ‘ordinary money’ and retail superannuation markets. In investment terms, these products are similar or indistinguishable. Differences lie in taxation and superannuation policy provisions rather than the underlying investments.
>
> As a result, there is duplication or overlap in the operational and compliance regimes for retail investments. The retail provider has to be both a single responsible entity (with associated reporting and compliance regime) for MIA, as well as an Approved Trustee (with that associated reporting and compliance regime) for SIS. Most obviously, retail providers must go through two establishment and approval processes, and must run two compliance schemes. (sub 32, p. 2)

IFSA also considered that some requirements under the MIA — in particular, certain duties imposed on responsible entities (table 7.1, note c) and requirements for compliance plans and committees — are ‘more comprehensive’ than those imposed on trustees under the SIS Act (sub 32, p. 5). This was confirmed in discussions with the Commission by other participants which provide retail investment products.

Just over 50 corporations that provide retail investment products are both responsible entities under the MIA and approved trustees under the SIS Act. This number would be higher if related corporations are considered.

Duplication between the SIS Act and the MIA arises out of the need for a number of corporations seeking to provide both ordinary investment products and superannuation products to:

- have separate trust structures;
- have separate compliance arrangements; and
- meet some similar covenants and duties (table 7.1).

There has been some coordination between APRA and ASIC in respect of the two Acts which should assist in 'containing' legislative duplication. A single application kit is available for applicants seeking both a dealer's licence from ASIC and trustee approval from APRA. A cross-industry circular on custodian requirements was issued jointly by APRA and ASIC so that approved trustees and responsible entities 'can meet the requirements of both regulators using one set of rules'. Moreover, ASIC has sought to harmonise its dealer licensing requirements with the approved trustee requirements. In particular, it treats the financial conditions imposed by APRA on approved trustees as an 'adequate substitute' for the standard surplus liquid funds requirements which it usually imposes on a dealer's licence (ASIC 2000, p. 70).

An option for dealing with legislative duplication would be for APRA to deem certain responsible entities that comply with the MIA, as having complied with corresponding requirements of the SIS Act for the purpose of providing superannuation products. In its initial submission to the Commission, IFSA proposed:

> The duplication, which arises from the dual coverage from SIS and MIA provisions over what are otherwise the same managed investments, could be avoided if retail investment fund managers were able to register and comply with one scheme, and have this carry across to the other environment. IFSA members have generally indicated a preference for the MIA scheme over SIS in this regard, on the basis that the MIA has clear and codified responsibilities and compliance processes. …
>
> IFSA suggests such an arrangement could readily be implemented through a provision which had the effect that a responsible entity (with an appropriate licence) is to be regarded as having met the obligations of those SIS provisions which cover approved trustees. In other words, compliance with MIA and licence conditions would be taken

as compliance with the relevant SIS provisions. Further, this arrangement could be a voluntary one, so that superannuation funds that do not experience the problem of duplication could remain regulated as they are now.

This proposed arrangement would not introduce more regulators than are currently involved in superannuation. (sub. 32, p. 7)

Table 7.1 **Covenants and duties in the SIS Act and the MIA**

SIS Act covenants[a]	*MIA duties*[b]
To act honestly.	To act honestly.
To exercise the same degree of care, skill and diligence as an *ordinary prudent person* would exercise in dealing with property of another for whom the person felt morally bound to provide.	To exercise the degree of care and diligence that a *reasonable person* would exercise if they were in the responsible entity's position.[c]
To ensure that the duties and powers are performed and exercised in the best interests of the beneficiaries.	To act in the best interests of the members and, if there is a conflict between the members' interests and its own interests, give priority to the members' interests.[c]
To keep the money and other assets of the entity separate from any money and assets respectively: that are held by the trustee personally; or that are money or assets of a standard employer sponsor or associate.	To ensure that scheme property is: clearly identified as scheme property; and held separately from property of the responsible entity and property of any other scheme.
To not enter into any contract or do anything else that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers.	Nothing within the Act.
To formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity including, but not limited to: the risk involved; the composition of the entity's investments as a whole including the extent to which the investments are diverse or involve the entity in being exposed to risks from inadequate diversification; the liquidity of the entity's investments having regard to its expected cash flow requirements; and the ability of the entity to discharge its existing and prospective liabilities.	Nothing within the Act.
If there are reserves of the entity – to formulate and give effect to a strategy for their prudential management, consistent with the entity's investment strategy and its capacity to discharge its liabilities (whether actual or contingent) as and when they fall due.	Nothing within the Act.

(Continued next page)

Table 7.1 **(continued)**

SIS Act covenants[a]	*MIA duties*[b]
To allow a beneficiary access to any prescribed information or any prescribed documents.	Nothing within the Act.
Additional covenants imposed on trustees may be prescribed in the Regulations.	Additional duties on the responsible entity are to: • treat the members who hold interests of the same class equally and members who hold interests of different classes fairly; • not make use of information acquired through being the responsible entity in order to: gain an improper advantage for itself or another person; or cause detriment to the members of the scheme; • ensure that the scheme's constitution meets specific requirements;[c] • ensure that the scheme's compliance plan meets specific requirements;[c] • comply with the scheme's compliance plan;[c] • ensure that the scheme property is valued at regular intervals appropriate to the nature of the property; • ensure that all payments out of the scheme property are made in accordance with the scheme's constitution and the Corporations Law; • report to the ASIC any breach as soon as practicable that: relates to the scheme and; has had (or is likely to have) a materially adverse effect on the interests of members;[c] and • carry out or comply with any other duty, not inconsistent with the Law, conferred by the scheme's constitution.

Notes: [a] Covenants are listed in section 52 of the SIS Act. [b] Duties are listed in section 601FC of the Corporations Law. [c] IFSA considered these duties to be more extensive than the SIS Act covenants.

This option would require APRA, with assistance from ASIC, to examine requirements under the SIS Act and the MIA with a view to determining the extent of areas of equivalence. Of course, as IFSA acknowledged, responsible entities would still need to comply with the retirement incomes policy provisions — such as the requirement on trustees that regulated superannuation funds be maintained for a sole purpose linked to retirement incomes, operating standards relating to who may contribute and the preservation of benefits, prohibitions on borrowing by trustees, and investment diversification — as well as other provisions of the SIS Act which are not dealt with in the MIA.

The option offers the potential to reduce legislative duplication — and, hence, unnecessary compliance costs — by reducing the need for certain providers of retail investment products to comply twice with equivalent legislative requirements. As the Institute of Chartered Accountants in Australia said:

> ... it costs [organisations] a lot of money to have two separate compliance frameworks and if one of those compliance frameworks quite clearly overlaps with another it makes sense to consolidate that. (trans., p. 24)

Having said that, the option raises a number of unresolved issues.

One issue relates to the precise extent of duplication. There is some duplication between the SIS Act and the MIA — for example, requirements for separate legal structures and compliance arrangements. However, this does not appear to be substantial. Indeed, there seem to be many areas within the Acts that are different (box 7.3).

Box 7.3 **Areas of dissimilarity between the SIS Act and the MIA**

There are many areas within the SIS Act which have no strict equivalent within the MIA, and vice versa. For example:

- many of the covenants imposed on trustees under the SIS Act in table 7.1 do not appear as duties imposed on responsible entities under the MIA — in particular, there is no duty on responsible entities such as the covenant imposed on trustees to formulate and give effect to an investment strategy;
- approved trustees are generally required to have access to at least $5 million net tangible assets or some approved form (such as a guarantee or $5 million held by a custodian), whereas responsible entities under sec. 784 of the Corporations Law are required to have a minimum of $50 000 net tangible assets or, where the value of scheme property is greater than $10 million, an amount equal to 0.5 per cent of those assets up to a maximum amount of $5 million;
- the consequences for trustees and responsible entities of contravening covenants and duties are not strictly equivalent — although both are subject to civil action for any contraventions, trustees are not subject to civil penalties such as pecuniary penalties, whereas responsible entities are; and
- responsible entities are required to have compliance plans and compliance committees (in certain circumstances), but trustees are generally not (although approved trustees must comply with prudential management certification conditions under APRA’s instrument of approval).

Even allowing for some duplication between the two Acts, a second issue is the associated compliance cost impact. The Commission has received little evidence of this. In its response to the draft report, IFSA said that it:

> ... is not aware of data that would allow ready calculation of the cost of duplication. Many activities are undertaken within compliance teams that cover both regimes and generally costs are not split. To produce disaggregated data would involve considerable effort and cost. (sub DR68, p. 3)

IFSA provided information to the Commission which showed that between 1996 and 2000, the total weighted management expense ratio for retail managed investment schemes declined by about 4 per cent (or 6 basis points). Since the introduction of the MIA in 1998, the decline was 2 per cent (or 3 basis points), amounting to an annualised cost-saving of about $26.8 million (KPMG 2001, p. 1). It is not possible to attribute the decline in the management expense ratio unequivocally to the introduction of the MIA. Other factors could have been relevant, including greater competition within the industry.

The Institute of Chartered Accountants in Australia considered the costs of compliance with the MIA to be greater than the costs of compliance with the SIS Act (sub 47, p. 4). For example, he estimated the cost of a compliance audit — a small component of total compliance costs — to be $5000 in respect of a 'non-public offer accumulation fund' subject to the SIS Act and $10 000 in respect of a similar sized investment fund subject to the MIA. However, while these estimates indicate that the cost of complying with an element of one Act is higher than another, they do not provide guidance on the compliance costs incurred as a result of duplication.

A third issue about the option relates to the robustness of the MIA requirements, in practice, compared with the corresponding SIS Act requirements. An ASIC surveillance of 83 responsible entities revealed breaches or compliance failures by 69 of them (ASIC 2001d). Of particular concern to ASIC was the 'lack of active implementation of compliance arrangements'. The Commission understands that only 9 of the 83 responsible entities were approved trustees. The surveillance also occurred only a few years after the introduction of the MIA; problems could be expected to arise in the early years of implementation. Thus, while of concern, it is difficult to draw any general conclusions from the ASIC surveillance about the extent of compliance with MIA requirements by responsible entities which are also approved trustees. However, the effectiveness of the MIA requirements is not entirely clear.

A fourth issue relates to the potential for the arrangements applying to providers of investment products, and to superannuation entities more generally, to become more complex. Even if APRA was satisfied that certain requirements under the MIA were equivalent to that of the SIS Act, there would be two regulatory regimes relating to superannuation entities, instead of one: one regime based on the SIS Act and applying to superannuation entities that are not part of the retail investment industry; and a second regime based on the MIA and part of the SIS Act and applying to retail investment providers seeking to offer superannuation products.

Other issues arising from the option relate to:

- the need for APRA to be satisfied that it could rely on ASIC's appraisal of responsible entities;
- how to determine whether responsible entities could be accepted by APRA as approved trustees under a deeming arrangement;
- the potential for uncertainty as to which regulator, ASIC or APRA, is ultimately responsible, including in circumstances where a provider of both ordinary investment and superannuation products was to fail;
- the scope for 'regulatory arbitrage' to occur — that is, for providers to choose to be regulated either by APRA or ASIC;
- whether consumers could be confused as to which regime applied; and
- the scope for benefits of reduced compliance costs to be passed on to consumers.

In the draft report, the Commission recognised that, for providers of ordinary investment and superannuation products that are subject to both the SIS Act and the MIA, there could well be additional compliance costs. However, the Commission said that it would need clearer identification of the extent of the duplication, further evidence about the extent of additional compliance costs due to duplication and of the benefits to consumers from the proposed option, as well as clearer resolution of other issues identified before endorsing this option.

In its response to the draft report, IFSA suggested that the Commission recommend that the duplication and inconsistency between the schemes be examined and resolved and, further, that there be harmonisation of the two regimes in such areas as reporting requirements and compliance activity (sub DR68, p. 3).

The Commission considers that a review held jointly by APRA and ASIC, together with industry of the scope to reduce regulatory duplication between the SIS legislation and the MIA would be beneficial.

RECOMMENDATION 7.3

Duplication between the SIS legislation and the Managed Investments Act should be reviewed jointly by the Australian Prudential Regulation Authority and the Australian Securities and Investment Commission together with industry. The aim of such a review should be to achieve consistency between the two regimes in their application to providers of retail investment products.

Life insurance companies

As noted in chapter 6, APRA and some other participants considered that, given the strong prudential requirements of the Life Insurance Act, the requirements of the SIS Act for a trust structure in life insurance companies for the provision of superannuation products achieve little additional purpose. They argued that the requirement may create a misleading impression among contributors that they are receiving a ‘level of duty’ from trustees that does not necessarily exist.

An option for reducing legislative duplication would be to remove the need for life insurance companies to comply with corresponding requirements in the SIS legislation. For example, APRA proposed that all superannuation business in life office statutory funds be written by way of contracts between members and the life company, rather than by an interposed trustee. Specifically, it said that:

> …. supervision for safety and soundness would be part of APRA’s life company prudential regulation with supervision for compliance with the retirement income standards made the responsibility of the life office board under a strict self assessment and certification process. (sub 36, pp. 7–8)

The Life Insurance Act affords protection for moneys in the statutory funds of life insurance companies. For example, there are requirements that:

- all amounts received by a life company in respect of the business of a fund must be credited to the fund;
- all assets and investments related to the business of a fund must be included in the fund;
- all liabilities (including policy liabilities) of the company arising out of the conduct of the business of a fund must be treated as liabilities of the fund;
- the assets of a fund are only available for expenditure related to the conduct of the business of the fund;
- statutory funds may not be restructured or terminated without the approval of APRA; and

- profits and losses of a statutory fund may only be dealt with in accordance with the objectives of protecting the interests of policy owners and prudent management of the fund (sec. 30).

Also, section 48 of the Act specifies that one of the duties of a director of a life company is:

> ... a duty to take reasonable care, and use due diligence, to see that, in the investment, administration and management of the assets of the fund, the life company:
>
> a) complies with [part 4 of the Act which sets out requirements relating to statutory funds]; and
>
> b) gives priority to the interests of owners and prospective owners of policies referable to the fund.

The section provides further that, in the event of a conflict between the interests of owners and prospective owners of policies referable to a statutory fund and the interests of shareholders of a life company, a director's duty is to take reasonable care, and use due diligence, to see that the company gives priority to the former over the latter.

The option of relying on the Life Insurance Act for the prudent management and prudential supervision of life insurance companies which write superannuation business in their statutory funds raises similar considerations to that of allowing certain responsible entities under the MIA to be deemed to comply with the SIS Act.

First, it could reduce some legislative duplication for life insurance companies and, thereby, reduce some compliance costs by not mandating a trust structure. At the draft report hearings, the Institute of Actuaries of Australia said that the costs incurred by life insurance companies in complying with both the SIS and the Life Insurance Acts were difficult to quantify, but the duplication was probably 'not a significant percentage of overall costs for the life office':

> ... 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 ... duplicated auditing ... some of the governance requirements are duplicated ... [and] duplicated capital requirements. (trans., p. 247)

A second consideration is the extent of the benefits that would be passed on to consumers should this option be implemented. This would depend on whether life insurance companies chose to operate without a trust structure. Some participants, however, considered that this would not necessarily be the case; it would depend on life insurance companies' perceptions of any market advantages to be had. For example, Zurich considered that if there was no requirement for a trust structure, some life insurance companies which chose to operate without trustees may market themselves as having lower fees, whereas others with trustees could claim they offered greater security. Furthermore, it was of the view that such marketing would cause uncertainty and confusion for the consumer.

Assuming that a life insurance company were to operate without a trust structure, the benefits passed on to consumers might not be significant. At the draft report hearings, the Institute of Actuaries of Australia said:

> ... 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 the change. But there certainly would be some savings and it's worth considering. (trans., p. 247)

A third consideration relates to the 'robustness' of the Life Insurance Act. Participants' comments on this were mixed. At the draft report hearings, the Institute of Actuaries of Australia said:

> ... 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. (trans., p. 248)

However, some participants raised concerns about the effect the option would have on the duties owing to members of superannuation entities. Trustees under the SIS Act are required to ensure that duties are performed and exercised in the best interests of the beneficiaries (table 7.1). As noted above, directors of a life company have a duty under the Life Insurance Act to give priority to the interests of policy holders over shareholders. Some participants argued that these duties are conceptually different. Jacques Martin said:

> There's so much potential for qualitative interest without the trustee structure interposed apart from the fact that there are obligations owed to shareholders and other stakeholders, particularly with things like life companies, ... It's a conflict of interest minefield in there. (trans., p. 368)

Similarly, ASFA supported the additional regulatory supervision that a trust structure demands:

> Where you have a trust structure which is operated by a life company and those funds which are gathered through that structure [are] 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. (trans., pp. 282–3)

Clearly, there would still be issues about the extent to which the requirements under the SIS Act and the Life Insurance Act are equivalent and the manner in which APRA would deal with those areas in the SIS Act which are not equivalent (such as the retirement income policy requirements).

However, compared with the MIA, APRA should be in better position to evaluate equivalence between the SIS Act and the Life Insurance Act. This is because it administers both of these Acts, whereas it has no administrative role in respect of the MIA.

The Commission is more confident about the application of an option to reduce legislative duplication in relation to superannuation contributions paid into statutory funds of life insurance companies than in relation to responsible entities which are subject to the MIA. It sees this option as having the potential to reduce the compliance costs of life insurance companies without compromising their prudent management and prudential supervision. However, the option would require careful consideration as to the detail. The Commission considers that APRA, together with industry, should review the possibility of permitting life insurance companies which write superannuation business in their statutory funds to be supervised under the Life Insurance Act for the prudent management of that business.

RECOMMENDATION 7.4

The Australian Prudential Regulation Authority should review the possibility of removing the need for life insurance companies which write superannuation business in their statutory funds to comply with the prudential requirements of the SIS legislation.

7.4 Option 4 — revise the structure of the legislation

This option involves a fundamental restructuring of the SIS legislation along the lines of the legislative structure which currently applies to authorised deposit-taking institutions under the *Banking Act 1959* and to the general insurance industry under the recently amended *Insurance Act 1973*.[2] The passage of the FSR legislation, which will involve significant consequential amendments to the SIS Act, affords an opportunity for fundamental restructuring to be made.

2 The Insurance Act was amended by the *General Insurance Reform Act 2001*.

Specifically, APRA proposed that the 'retirement income aspects' be placed in other legislation and that a three-tiered legislative framework apply in respect of the prudential supervision of superannuation entities. The three tiers would consist of:

- an enabling Act setting out broad objectives and higher order principles;
- 'flexible, plain English' standards issued by APRA, which may be disallowable instruments by Parliament and which may enable it to avoid some elements of the process that currently applies to the making of regulations; and
- explanatory guidelines that provide additional detail on the application of the standards (sub. 36, pp. 6–7).

The standards could cover matters relating to the operations of the superannuation entity such as the investment of assets, the number of trustees and the composition of boards or committees of trustees, record keeping, financial and actuarial reporting, funding and solvency, and winding-up (for example, see sec. 31 of the SIS Act).

This option has the potential to permit more flexible and timely regulatory responses to market-driven changes within the superannuation industry, as well as to the different risks associated with different superannuation entities. As APRA said, the three-tiered framework '… permits quick responses to technological, market, industry or single institution developments' (sub. 36, p. 7). This was supported by Jacques Martin which said:

> Given the nature of the superannuation industry, its magnitude and diversity, and the prudential risks faced within the industry, it may be desirable to impart a degree of flexibility and discretion to the Regulation to enable it to react and respond appropriately to changing circumstances. (sub DR62, p. 27)

Figure 7.1 sets out the key elements of the processes for making regulations and standards in the context of prudential supervision and prudent management. Regulation impact statements as well as consultation is currently a part of the regulation-making process and would be expected to be part of the standard-setting process. The Commission understands that the time involved in the process for making regulations under the SIS legislation varies substantially and has extended up to two years. The standard-setting process could be quicker than the more formal process involved in amending an Act or making regulations.

The option could be seen as reducing complexity in the enabling Act by removing both existing retirement income policy provisions and prescriptive operational detail. However, this would not remove complexity so much as shift it to other legislation. Hence, there might be no real reduction in overall complexity or in compliance costs. Moreover, superannuation entities would no longer have their prudential and retirement income policy requirements contained in a single Act, which could complicate their compliance task. At the draft report hearings, ASFA expressed reservations about the carving out of retirement income aspects from the legislation:

> I know we've now got sort of consumer issues in 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. … 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. (trans., p. 289)

Figure 7.1 **Regulation-making versus standard-setting processes**

Regulation-making process	Standard-setting process
APRA proposes regulations and advises Treasury	APRA proposes standards
↓	↓
Treasury instructs the Office of Legislative Drafting	APRA instructs internal drafting section
↓	↓
Office of Legislative Drafting drafts regulations	APRA drafts standards
↓	↓
Treasury submits regulations to Minister for approval	APRA delegate signs off on (that is, makes) finalised standards
↓	↓
If Minister approves the regulations, Treasury lodges regulations with the Federal Executive Council Secretariat	Standards are notified in the Gazette and may commence after this date
↓	↓
The Federal Executive Council (Governor-General) makes regulations	Standards are tabled in Parliament within 15 sitting days of being made and subject to scrutiny and disallowance by Parliament
↓	↓
Regulations are notified in the Gazette and may commence after this date	If standard is disallowed by either House of Parliament, standard is repealed.
↓	
Regulations are tabled in Parliament within 15 sitting days of being made and subject to scrutiny and disallowance by Parliament	
↓	
If regulation is disallowed by either House of Parliament, regulation is repealed.	

Indeed, whether it is possible to delineate retirement incomes aspects of the SIS legislation clearly from prudent management and prudential supervision aspects is an issue. Even if it could be done, another issue is which regulatory body would be assigned with administrative responsibility for the retirement incomes aspects.

A disadvantage of the option is that it could lead to the establishment of higher or more stringent standards applying to the operations of superannuation entities than those which currently exist, with resultant costs for those entities and their members.

It could also involve some loss of accountability and diminution in the quality of legislative drafting; as figure 7.1 shows, the option implies that formal input from the Treasurer, Treasury and the Office of Legislative Drafting could be avoided.

Another disadvantage of the option is that, by giving APRA increased discretion to determine standards, the option could contribute to greater uncertainty amongst superannuation entities, requiring them in some instances to have increased resort to legal advice about the standards. This uncertainty could arise because of the possibility of more frequent changes — indeed, it may not be ideal for a long-term superannuation investment to be subject to periodic discretionary changes in the standards — as well as concerns about legal enforceability.

To guard against this, the exercise of discretion by APRA would need to be accompanied by extensive and robust public consultation, not only with trustees and others in the industry, but also with members of superannuation entities. It would also be important to ensure that the standards were disallowable instruments, which would ensure Parliamentary scrutiny. The need for Parliamentary or Ministerial scrutiny was supported by Jacques Martin (sub D62, p. 27). Similarly, at the draft report hearings, ASFA said:

> We would probably need to see APRA perform better before we would want it to be given more powers. … although the notion of using disallowable instruments rather than law is something that … we think quite kindly of … in other areas … the disallowable instrument which turns into regulation in effect is probably safer than if [APRA] had just [been] given powers to make policies which are enforceable without having to go back to Parliament. (trans., p. 291)

A final disadvantage of the option is that the regulatory models on which this option is based — that is, those applying to the banking industry — might not work as well in the superannuation industry. The latter is characterised by a much larger number and more diverse range of entities.

The Commission considers that while this option would have some apparent advantages to APRA, it is not clear whether it would reduce the overall complexity and prescription of the legislation or compliance costs. It is also not clear whether the option would increase the effectiveness of the legislation in meeting its objectives, or whether this benefit would outweigh the costs involved with the exercise of greater regulatory discretion and additional uncertainty.

The Commission does not favour this option.

7.5 Preferred option

The Commission's preferred approach consists of the combination of options 1 and 2. Option 1 would reduce some of the complexity in the legislation with consequent reductions in compliance costs and enhance somewhat the effectiveness of some provisions of the legislation. It could also increase competition within the industry. Option 2 would enable the legislation to achieve its prudent management and prudential supervision objectives more effectively. Together, the options would have the potential to bring net benefits to members of superannuation entities and to the community.

The Commission's analysis and recommendations in respect of the other Acts under review are presented in the next two chapters.

8 Superannuation (Resolution of Complaints) Act 1993

The *Superannuation (Resolution of Complaints) Act 1993* provides for the establishment and operation of a statutory alternative disputes resolution body, the Superannuation Complaints Tribunal, to resolve complaints that cannot be settled between a superannuation fund member and trustee, insurer or other provider. The Commission considers that the benefits of the alternative disputes resolution provided by the Tribunal outweigh the costs when measured against the alternative of reliance on the court system. In its assessment of alternative means of achieving the resolution of complaints objective of the Act, the Commission, on balance, is not convinced of the need to maintain a statutory structure to provide such a service to members. The Commission recommends that the legislation be repealed and that trustees be required by law to join an ASIC-approved disputes resolution body, as occurs elsewhere in the financial sector. This would become part of the compliance requirements for APRA-regulated superannuation funds. The Commission also finds that there is scope for improvement of the existing internal complaints arrangements.

As part of this inquiry, the Commission was asked to review the *Superannuation (Resolution of Complaints) Act 1993* (hereafter referred to as the Resolution of Complaints Act). The SIS Act, section 101, imposes a duty on trustees of regulated superannuation funds, other than self-managed superannuation funds (SMSFs) and approved deposit funds, to establish arrangements for dealing with inquiries and complaints. These arrangements provide for the internal resolution of complaints between fund members and their trustees. The Resolution of Complaints Act provides for the establishment and operation of the Superannuation Complaints Tribunal (hereafter referred to as the Tribunal) to resolve externally certain member complaints which are unable to be resolved with their trustee internally. Typically, these are complaints relating to disability benefits, death benefits, administration and account balance/benefit calculations.

In its examination of the Resolution of Complaints Act, the Commission has sought to address two main questions. The first relates to whether the provision of an external disputes resolution body to resolve member complaints which are unable to be resolved internally with their trustee, insurer or other provider gives greater benefits than costs when compared with reliance on the courts to resolve disputes. The second question is whether a statutory body is the most appropriate form for an external disputes resolution body. The Commission has also given consideration to the possible scope for improvement in the cost-effectiveness of the current arrangements for the handling of disputes.

8.1 Background

The Government established the Tribunal as an independent statutory authority, following a recommendation from the Senate Select Committee on Superannuation (SSCS) in 1992 for the setting up by legislation of an external disputes resolution mechanism for the industry. It recommended a management board comprising nominees of the Commonwealth and participating State governments, industry bodies and representatives of the unions, women's and consumer groups and a review authority chaired by an ombudsman, who would sit with two other members drawn from a panel of fund trustees and other people with appropriate experience. The SSCS found that for the 'hard core of disputes that cannot be resolved internally,' the only external avenue of review was through the court system that it regarded as 'a costly, time-consuming and often distressing process' (SSCS 1992).

The Tribunal commenced operations on 1 July 1994, although not in the form envisaged by the SSCS. The Tribunal's statutory objectives are to provide complaints resolution mechanisms that are 'fair, economical, informal and quick' (as set out in section 11 of the Act). The Tribunal is required to inquire into a complaint and try to resolve it by conciliation. If conciliation is unsuccessful, then it will review the complaint and issue a determination.

The Tribunal deals with superannuation-related complaints about the decisions and/or conduct of trustees, insurers, retirement savings account providers, superannuation providers and other relevant decision-makers in relation to SIS-regulated superannuation funds; approved deposit funds; life policy funds; annuity policies; retirement savings accounts; and the surcharge contributions tax (Resolution of Complaints Act, part 4).

The Tribunal can deal with a range of complaints including: a refusal to approve a claim for disability benefit; a belief that a death benefit was paid or may be paid to the wrong person; a miscalculation in benefit; errors in annual statements; and misrepresentation about the terms and conditions of an annuity policy and/or life policy fund.

However, the Tribunal is not permitted under the Act to deal with all superannuation-related grievances. For example, it does not have jurisdiction to deal with the following complaints:

- those that have not first been subject to a fund or provider's internal complaints mechanism (usually within 90 days);
- those relating to 'management of the fund as a whole';
- those relating to exempt public sector superannuation schemes;
- those relating to SMSFs regulated by the ATO; and
- those where the subject matter of the complaint is the subject of court proceedings (Resolution of Complaints Act, parts 1 and 4).

Mandatory time limits apply for the lodging of complaints for disability (one year) and for death benefit (generally within 28 days).

The Tribunal has the power to make a determination on a complaint that is binding on the trustee and/or insurer and the complainant. Where a complainant is dissatisfied with a decision, he/she can seek redress in the courts only on questions of law. The Act currently precludes the Tribunal from disclosing the names of complainants and superannuation funds that are subject to complaints handled by review.

During 2000-01, the Tribunal received 1856 written complaints. Just over half of these were outside the Tribunal's jurisdiction. Complaints relating to the payment of 'disability' and 'death' benefits continued to comprise the largest categories of all written complaints received that were within the Tribunal's jurisdiction. They accounted for 55 per cent of such complaints in 2000-01.

Complaints may be resolved in three ways. They may be withdrawn by the Tribunal, withdrawn by a complainant, or determined at review.

The Tribunal may decide to treat the complaint as 'withdrawn' in the following circumstances:

- the complainant fails to reply to any correspondence or phone calls over a significant period of time;
- more than 12 months have elapsed since the fund trustee/life company/retirement savings account provider decision;
- the complaint is considered to be trivial, vexatious, misconceived or lacking in substance; or

- the subject matter of the complaint has been, or is likely to be, dealt with by another body or statutory authority, or has already been dealt with by the Tribunal itself.

After being received and investigated by a Tribunal officer, a complaint may be resolved without the need for a conciliation conference. If so, it is regarded as being ‘withdrawn’ by the complainant at the pre-conciliation stage. If, however, a conciliation conference has to be held and a complaint is subsequently settled by agreement between the parties, the complaint is regarded as withdrawn by the complainant at the post-conciliation conference stage (in accordance with section 31 of the Act).

If a complaint has not been resolved at the inquiry or conciliation stage and it has not been withdrawn by the Tribunal, then the Tribunal will hold a review meeting to determine the outcome.

During 2000-01, the Tribunal actually dealt with 1839 written complaints (table 8.1). Only 46 per cent of them fell within its jurisdiction. Of these 853 complaints, two out of three were resolved or withdrawn at the inquiry and conciliation stages prior to review by the Tribunal. They included 46 complaints (5 per cent of the total) that were withdrawn by complainants without resolution. At review, the Tribunal varied or set aside the trustee’s decision in 45 per cent of cases. Overall, of the 853 complaints, around 57 per cent were resolved in favour of complainants (SCT 2001a).

Table 8.1 **Complaints resolved/withdrawn, 2000-01**

	Complaints		
	No.	Total	%
Withdrawn by the Tribunal		167	20
Withdrawn by complainant			
Pre-conciliation conference	215		
Post-conciliation conference	124	339	40
Without resolution		46	5
Resolved by Tribunal at review			
Decision affirmed	153		
Decision remitted back to trustee	11		
Decision varied	8		
Decision set aside/substituted	128		
Decision no jurisdiction	1	301	35
Total		**853**	**100**

Source: SCT (2001a).

Funding for the Tribunal for 2001-02 is expected to total $2.2 million, compared with $2.4 million for the previous year. This equates to a cost of about $1300 per written complaint dealt with in 2000-01. The operating costs of the Tribunal are funded through the Commonwealth budget and recovered in full from the superannuation industry through the Financial Sector Levy, which is administered by APRA. The Tribunal's budget comes within ASIC's budget allocation.

There is no fee for lodging a complaint with the Tribunal. Nor are any of the Tribunal's costs charged to complainants.

8.2 Overall assessment of disputes resolution

Disputes resolution in the superannuation industry, as elsewhere in the financial sector, involves a combination of internal complaints processes and a subsequent external disputes resolution process.

Internal complaints resolution process

There was no questioning of the legislative requirement for APRA-regulated funds to provide internal complaints arrangements. The Commission considers that the benefits of the requirement far exceed its costs, especially when viewed in the wider context of disputes settlement more generally.

The Commission, nevertheless, considers that there is scope to reduce the costs of external disputes resolution through more efficient use of internal mechanisms for handling inquiries and complaints. The SIS Regulations (reg. 2.28) require trustees to give to each member of the fund details (in summary form) of arrangements that the fund has established to deal with inquiries or complaints. They do not indicate that the member must first use the internal complaints arrangements before approaching the Tribunal. However, Superannuation Circular No I.E.1, issued by the Insurance and Superannuation Commission in December 1994, includes advice that trustees should inform members that a complaint can only be dealt with by the Tribunal after it has been through a fund's internal process. Despite this, a large number of complaints are made to the Tribunal without following this process.

Jacques Martin Industry Funds Administration Pty Ltd (Jacques Martin) noted that:

> … despite the absence of regulatory prescription, a number of funds do advise members that they must use the fund's internal dispute handling mechanism before approaching the Tribunal. Furthermore, during its establishment the Tribunal released some suggested wording with respect to its existence and function which is frequently

> adopted by funds and which refers to the requirement for members to have been through the fund's internal complaint resolution process. (sub. DR62, p. 29)

Further, Jacques Martin suggested:

> One possible alternative may include measures such as requiring the member to lodge documentary evidence of having been through the fund's internal complaints handling mechanism prior to lodging the complaint with the Tribunal. (DR62, p. 33)

Under the SIS Act, trustees are also required to provide fund members with certain information about the existence and functions of the Tribunal. (These are also set out in Superannuation Circular No I.E.1.) However, the SIS Act disclosure requirements do not oblige the trustee to outline the types of complaints that are specified in the Resolution of Complaints Act as falling outside the Tribunal's jurisdiction. It would be desirable that trustees be required to do so for the types of complaints relevant to their members, in order to reduce costs incurred by the Tribunal in assessing the initial eligibility of complaints, as well as the cost to members in terms of misplaced effort. This could be done by way of a general statement outlining the type of relevant complaints excluded by the Act. Such a procedure would not mean that trustees would rule on the individual merits of each case. Rather, it would be a means of educating members about the statutory requirements of the Act.

Jacques Martin agreed with the following recommendation and suggested that the 'Tribunal could provide some recommended wording for this purpose' (sub. DR62, p. 30). Similarly, Maurice Blackburn Cashman suggested that 'a standard form of words should either be mandated by way of a Regulation to the Act, or offered as a guide by the Tribunal, perhaps as a Practice Note' (sub. DR54, p. 9).

RECOMMENDATION 8.1

Trustees should provide members with information about the categories of complaints that are excluded by legislation from consideration by the Superannuation Complaints Tribunal.

A guidance note to fund trustees may be a useful device for this purpose to encourage consistency across the industry.

External disputes resolution process

Benefits

The major benefits of Resolution of Complaints legislation derive from the cost savings and improved equity of having an alternative external disputes resolution process compared with reliance on the court system.

In the absence of the Tribunal (or any alternative disputes resolution scheme), members would need to pursue any grievance that could not be resolved with trustees through the court system, which could be a costly, formal and time-consuming process. The first inquiry of the SSCS supported establishing a disputes resolution mechanism that 'avoided the courts as far as possible'. It noted that 'the cost of litigation in the courts was so high that it offered no real rights to members' (SSCS 1992, p. 136).

Maurice Blackburn Cashman commented on the high cost of the court system. It stated:

> In regards to costs, the Tribunal compares very favourably with the civil courts. … the costs involved in taking a civil court action to judgement are very substantial. For example, the costs involved in taking a matter to judgement in the Victorian Supreme Court could range from $20,000 to upwards of $60,000 for each party. (sub. DR54, p. 4)

The Commission's work on the provision of Commonwealth and State services provides some indication of the timeliness of the court system. It found that, on average, the supreme/federal courts in the Commonwealth and all States and Territories finalised 67 per cent of civil cases within 12 months. (SCRCSSP 2001, vol. 1, p. 419).

The Tribunal has not been able to provide the Commission with data on the cost and average time taken to resolve complaints. However, the Tribunal has indicated to the Commission that where the Tribunal has cause to withdraw a matter, it aims to do so within 1–2 months of the complaint being received; for matters successfully conciliated, within 2–3 months; and for matters determined at review it aims to hand down a determination within 6–8 months. The Tribunal notes that it can take a minimum of three months for a complaint lodged with the Tribunal to reach a review meeting due to legislative and administrative time constraints. This broadly appears to compare favourably with the courts.

The high cost of the court system would be likely to deter fund members, especially those with smaller claims, from pursuing legitimate grievances. Such fund members are more likely to be those with smaller superannuation accounts as a result of their modest financial position or status as occasional contributors. Thus, the service provided by the Tribunal that is free of charge to complainants is certainly cheaper to them than the alternative of using the courts and has contributed to improving equity more generally among fund members.

The Tribunal's reporting obligations, as set out in the Act, represent an additional benefit by providing information for the regulator. This information is provided in the form of an annual report containing data on the number and nature of complaints and indicating the way in which they are handled. Such information may not be so easily accessible through the court system. In addition, the Tribunal reports individual breaches of the SIS legislation and regulations and publishes Tribunal decisions.

Costs

In addition to the administrative cost of the Tribunal, there is also the cost to funds and certain service providers of complying with the Tribunal's processes and the cost to members in making the complaint. The requirement within the Resolution of Complaints Act that complainants must first try to resolve any grievance through a fund's internal complaints process serves to contain the additional cost of pursuing any matter through the Tribunal. As PricewaterhouseCoopers said:

> Most funds have found that complying with the Tribunal's requirements is simply a matter of copying information that has already been provided to members through their own internal complaints process and as such does not represent a significant cost to other members of their funds. (sub. 14, p. 15)

The Institute of Chartered Accountants in Australia stated that:

> The requirement to seek redress through internal complaints mechanisms and conciliation weeds out vexatious and minor dissatisfactions and helps to ensure that only cases where there is a serious grievance are brought to the tribunal. This keeps the costs of operating the tribunal low. (sub. 9, p. 8)

Nevertheless, more than half the written complaints received by the Tribunal in 2000-01 were outside its jurisdiction, a situation that involves avoidable costs (SCT 2001a, p. 26). There is also the cost of delays in resolving complaints. The Commission notes that after two years of operation the Tribunal, at 30 June 1996, already had a backlog of some 577 outstanding complaints (SCT 1996, p. 5). The Tribunal's operations were then severely curtailed by Federal Court judgements in 1997 and 1998. This resulted in the further accumulation of a large backlog of complaints, leading to delays in the Tribunal hearing more current cases. The Tribunal's full powers were restored by the High Court in June 1999.

It is expected that increased funding allocations announced in the last two Commonwealth Budgets, together with the Government decision to appoint additional Tribunal members in 2001, should allow the Tribunal to overcome the current backlog by early 2002 (Hockey 2001b). The Tribunal reported that 'we have disposed of all 1998 and 1999 cases, with a handful of exceptions. The Tribunal continues to make good progress with complaints lodged in the year 2000. Just over 86% of these complaints have been dealt with and closed'. At the end of September 2001, 891 matters remained open (SCT 2001b).

Assessment

The Commission has not received information to suggest that the operation of the Resolution of Complaints legislation raises issues in relation to the restriction of competition that need to be addressed.

Participants in the inquiry generally expressed support for the continued operation of the Tribunal. For example, PricewaterhouseCoopers stated that:

> Our experience indicates that the Complaints Tribunal is working well. It facilitates the resolution of disputes and misunderstandings which would otherwise be very costly to resolve through the courts. (sub. 14, p. 15)

The available evidence clearly indicates that the benefits of the legislation in providing an alternative external disputes resolution scheme to reliance on the court system outweigh the costs involved. In particular, there are significant cost savings to complainants and improved equity overall among members and beneficiaries.

The Commission considers that the legislative requirement for resolution of complaints mechanisms by APRA-regulated superannuation entities is warranted.

8.3 Alternative means of external disputes resolution

As part of its terms of reference, the Commission must also consider whether there are alternative ways of resolving complaints about superannuation. The benefits of the legislation, outlined above, might be obtainable from different disputes resolution mechanisms, such as industry-based complaints bodies, which operate elsewhere in the financial sector. In considering alternative external disputes resolution mechanisms, it is useful to review the development of alternative disputes resolution schemes in the financial sector since the Tribunal was set up in the early 1990s.

Industry-based schemes in the financial sector are now regulated by ASIC, which recently released guidelines that have been developed to ensure the independence, integrity and current relevance of such schemes (ASIC 1999a, Policy Statement (PS) 139 — box 8.1). These provide the criteria which include strong minimum standards against which ASIC assesses alternative disputes resolution schemes (ASIC 1999a, PS 139.127–8). For example, in order to ensure a scheme's independence, an overseeing body should comprise equal numbers of consumer and industry representatives and an independent chair. ASIC has recently approved three schemes — the Financial Industry Complaints Service (FICS), Banking Industry Ombudsman (BIO) and the General Insurance Enquiries and Complaints (IEC) scheme — in accordance with these guidelines. ASIC requires that a scheme's operations and procedures be subject to independent review every three years or sooner, if appropriate (ASIC 1999a, PS 139.92). If approved schemes do not comply with their obligations under PS 139, ASIC can take remedial action in a number of ways — such as varying a scheme's licence conditions or, as a last resort, revoking a licence (ASIC 1999a, PS 139.128).

Box 8.1 **ASIC Policy Statement 139: Approval of External Complaints Resolution Schemes**

The guidelines cover such issues as:

- independence of the scheme;
- coverage of the scheme: wide coverage so that most consumer complaints can be heard by the scheme;
- changes to the terms of reference;
- cost to the complainant: low cost access to schemes by community;
- scheme decision-making;
- compliance with scheme decisions;
- available remedies;
- reporting to ASIC: systemic issues, alleged serious misconduct and serious misconduct;
- complaints information: effective reporting of complaints trends and problems;
- internal dispute resolution timeframes;
- promotion of the scheme: adequate public promotion of the scheme; and
- independent reviews: regular independent reviews of the scheme's operation.

Source: ASIC (1999a).

The Commission notes that the recent approval of the BIO by ASIC involved changes to the structure of the scheme to emphasise its independence by replacing the previous dual structure consisting of a council, comprising entirely industry members, and a board with a single board with equal representation.

The three approved industry-operated external disputes resolution schemes operating in the financial sector are outlined below.

Financial Industry Complaints Service

The FICS operates to help consumers in the resolution of complaints relating to members of the financial services industry. It deals with complaints against a range of service providers, including life insurance firms, superannuation funds (for complaints outside the Tribunal's jurisdiction), investment funds managers, financial advisers, investment advisers, stock-brokers and sellers of financial or investment products. Its membership has recently expanded to more than 1600.

The Board of Directors of FICS consists of an independent chairperson appointed by the Investment and Financial Services Association Ltd (IFSA), four industry representatives, appointed by IFSA, and four directors appointed by the Federal Minister for Consumer Affairs. This is in accordance with ASIC guidelines for an external complaints resolution scheme.

The Service is free of charge to complainants and its operating costs are met by the members. In addition to annual fees, members of the service are charged a fee for initial investigation of a complaint by FICS. Additional amounts are charged for complaints that require an adjudicator or referral to a panel. Where the amount involved is $10 000 or less, an adjudicator will make a decision. If after investigation, negotiation or conciliation, a complainant is dissatisfied with the result, he/she can ask the Service to refer the complaint to a panel (for matters involving more than $10 000 or for more complex matters) for a decision on the matter. A panel consists of an independent chairperson, a representative of the interests of consumers selected from a list of persons appointed by the Minister and a person representing the interests of a relevant section of the financial services industry selected from a list of persons appointed by IFSA.

Decisions made by an adjudicator or panel of the service are binding on members, but are not binding on the complainant. A member who does not comply with a decision of a panel may have its membership terminated. However, the service must consult with ASIC prior to such action being taken. It is unable to deal with a complaint about a person or corporation who is not a member of the service.

During 2000, FICS received 812 new complaints and finalised 766 cases over the same period. In relation to insurance complaints, FICS handled 16 per cent within 60 days and 40 per cent within 120 days (FICS 2001a).

Banking Industry Ombudsman

The BIO helps individual customers and small businesses of all member banks to resolve complaints with those banks. The Banking Code of Practice requires banks to provide personal customers with a free, external and independent process for resolving disputes. However, where small businesses want more than an initial consideration of the merits of their case, a fee is payable. This may be refunded depending on the outcome of the case.

In order to ensure the independence of the Ombudsman, a board consisting of three consumer and small business representatives and three bank representatives and an independent chairperson stands between the Ombudsman's office and the member banks.

Member banks fund the scheme. In addition to a participation fee by member banks, a levy is paid according to the number of complaints and their complexity. Charges increase progressively for more complex cases requiring greater examination and a larger number of contacts with a bank and complainant.

The Ombudsman's decision is binding on a bank only if a complainant accepts the decision. It remains open for the complainant to reject a decision of the Ombudsman and to pursue other avenues. An award to a complainant cannot exceed an amount of $150 000.

The BIO received 7199 written complaints during 2000-01. Of the 6872 cases that were closed during that same period, 16 per cent were discontinued cases and 19 per cent were outside the scheme's jurisdiction. More than 80 per cent of the remaining 4427 cases were resolved after referral to the bank and without the need for investigation by the BIO. These remaining 779 cases were investigated by the BIO and closed after a finding, negotiated settlement, conciliation conference or Ombudsman's recommendation. Of the cases referred to a bank, 40 per cent were closed within 60 days. The median duration of open cases at 30 June 2001 was 52 days .

The *Financial Services Reform Act 2001* (FSR Act), which takes effect from March 2002, requires all finance industry participants to be a member of an ASIC-approved consumer complaints resolution scheme. ASIC announced approval of the BIO scheme in September 2001 (ASIC 2001a). The terms of reference are to be expanded in the coming year to allow the Ombudsman to consider complaints about the whole bank group (which could include complaints about the banks' superannuation business). The definition of small business is also to be amended to allow access to the scheme by more businesses.

General Insurance Enquiries and Complaints scheme

The IEC scheme is a national scheme for consumers to resolve disputes with their insurance companies, or for claimants to resolve a dispute with another person's insurance company in relation to motor vehicle property damage (third party claim). The scheme began operations in December 1991.

Insurance Enquiries and Complaints Ltd is a company whose members are participating general insurers. It acts as the secretariat to the scheme. Participating insurers fund the scheme. They sign an agreement indicating their compliance with the scheme's terms of reference.

The scheme's board of directors consists of an independent chairperson appointed by the Insurance Council of Australia ICA; four members with experience in consumer affairs appointed by the Federal Minister for Consumer Affairs; three participating general insurance company members appointed at the IEC annual general meeting; and the executive director of the Insurance Council of Australia. The responsibilities of the board include overseeing and monitoring the activity of the scheme and ensuring the independence of the disputes resolution process and effecting changes to the terms of reference following consultation with its members, the Federal Minister for Consumer Affairs, the Insurance Council of Australia, ASIC and such consumer groups as the board considers appropriate. The board has no power to overturn any decision of the panels, referee or the adjudicator.

The scheme is free to those who have a dispute with their insurance company. However, a fee of $150 applies to disputes for third party claims.

The scheme operates on two levels. At the first tier, consumer consultants provide advice about inquiries and assistance in encouraging resolution of disputes by promoting conciliation between complainants and insurance companies. If a claims dispute falling within the scope of the scheme remains unresolved following the internal disputes resolution process of the insurer, it can be referred to the second tier of the scheme. At this tier, a claims review panel (panel), referee or adjudicator offers complainants an impartial alternative to litigation.

The panel, referee and adjudicator operate as the determination arm of the scheme. The panel determines most disputes. When fraud is alleged, however, the matter will be determined by the referee. Binding determinations can be made on participating insurers by an adjudicator for amounts of $3000 or less and by a panel or referee for amounts of $120 000 or less. The scheme can also recommend settlements involving amounts up to $290 000. Complainants are not bound by any determination and retain the right to legal action or other forms of redress if dissatisfied with a determination.

The scheme is funded in part by a levy on insurers. Charges on members for handling complaints account for about half of the scheme's total budget outlays. For disputes dealt with by a panel, there is a higher charge if the complaint is not resolved in the insurer's favour. Fees are much higher in the cases of fraud, where matters are investigated face to face.

During 1999-2000, 2325 referrals were received for resolution, with 2196 of these completed. Eighty-nine per cent of these were resolved within 120 days.

Data relating to the operation of industry-based schemes and the Tribunal is shown in table 8.2.

Table 8.2 **Data on operations of external disputes resolution bodies**

	FICS	*BIO*	*IEC*	*Tribunal*
Year	2000	2000-01	1999-2000	2000-01
Timeliness	16% in 60 days, 40% in 120 days for insurance.	40% in 60 days, 75% in 120 days.	89% in 120 days.	No data available. Expect to: consider 1-2 mths conciliate 2-3 mths review 6-8 mths.
No. of complaints received	812	7199	2325	1856
No. of complaints dealt with	766 cases finalised.	6872 closed, 16% discontinued, 19% outside jurisdiction. Of remaining 4427 cases 82% resolved after referral to bank. Other 18% (779 cases) closed after a finding, negotiated settlement, conciliation conference or Ombudsman's recommendation.	2196 completed 1676 determined by IEC.	1839, with 54% outside jurisdiction. 853 withdrawn by Tribunal/ complainant or resolved.

Sources: BIO (2001a); FICS (2001a); IEC (2001a); SCT 2001a.

Draft report proposal

In the draft report, the Commission considered that while there were clear benefits from legislating for the provision of internal and external disputes resolution, there was not sufficient justification to continue to require separate legislative provision of external disputes resolution by the formation of a statutory body. The alternative of an independent industry-based scheme was regarded as being more appropriate for achieving the objective of external disputes resolution. As indicated above, such schemes operate successfully elsewhere in the financial sector and are now regulated by ASIC. Their coverage will become more widespread with implementation of the FSR legislation, which requires licensed providers of financial services to join an approved external disputes resolution scheme.

Accordingly, the Commission recommended repeal of the Resolution of Complaints Act and the introduction, as part of the compliance requirements for all APRA-regulated superannuation entities, of a requirement for them to join an industry-based alternative disputes resolution scheme approved by ASIC.

Participants' comments

While some participants supported the recommendation — Corporate Super Association (trans., p. 469) and the Institute of Chartered Accountants in Australia (trans., p. 329) — the majority strongly opposed it. For example, the Association of Superannuation Funds of Australia said:

> We fail to see any strong evidence that the SCT [Superannuation Complaints Tribunal] has in any way acted as a barrier to competition or efficiency. Further there is no convincing evidence that the SCT has failed to meet its role as a dispute resolution forum. (sub. DR56, p. 9)

The Industry Funds Forum stated:

> The IFF strongly rejects this recommendation. We believe that the Superannuation Complaints Tribunal has performed a sound role in dealing with disputes in this industry. In particular now that its constitutional status has been clarified we believe that the Tribunal should remain to provide the services to superannuation fund members that were contemplated when the Act establishing the Tribunal was passed in 1993. (sub. DR57, p. 3)

Maurice Blackburn Cashman stated that 'it is our strong view that the SCT should be retained in its present form and the Act should not be repealed' (sub. DR54, p. 1).

Participants based their views on a number of considerations. They include:

- the statutory independence of the Tribunal;
- procedures involved in the resolution of complaints (eg. the binding nature of Tribunal determinations and dissemination of information on its decisions); and
- the absence of monetary limits on complaints considered by the Tribunal.

Independence

The independence of a complaints resolution body is central to its integrity and to community acceptance of its determinations. Some participants considered that this was an important benefit that was ensured by the Resolution of Complaints Act.

As Maurice Blackburn Cashman stated:

> Without independence, both real and perceived, consumers will not have confidence that their grievances will be properly dealt with and they will abandon the alternative dispute resolution scheme in favour of the traditionally independent Court system.
>
> The SCT is an alternative dispute resolution scheme with statutorially enshrined protections for independence, including the appointment of the Chairperson, Deputy Chairperson and part time Tribunal members, prescribed jurisdictional limits, powers and procedures, and defined funding sources. As a creature of statute, its rules and protections cannot be varied, except by Federal Parliament. (sub. DR54, p. 5)

In addition, Jacques Martin said:

> The Tribunal has the added advantage that, as a statutory body, it is truly independent. As justice not only has to be done, but has to be seen to be done … we consider the statutory independence of the Tribunal to be of paramount importance. (sub. DR62, p. 32)

A few doubted that independence could be achieved by industry-based schemes. For example, the Chairman of the Tribunal claimed that ‘as a matter of fact, industry-based complaints resolution schemes are subject to influence from the industry setting them up’ (sub. DR60, p. 4).

On the other hand, Maurice Blackburn Cashman said:

> The first level, which is the most important level, is at the panel level, which is the dispute fact-finder. They ultimately make the decisions. I have not seen any evidence – I was on the panel of FICS for six years … I never saw any attempts to influence us in what we did by any industry body member. ... I have not heard of any such thing with the IEC.
>
> … we’ve got confidence in all these [alternative dispute resolution] schemes – we encourage people to take complaints there, rather than channel them to the courts. (trans., pp. 385–6)

The schemes (FICS, BIO and IEC) that have been operating in the financial sector for around a decade have taken steps and developed procedures for ensuring their independence. More recently, these developments have been reinforced by ASIC regulation of external complaints resolution schemes (ASIC 1999a, PS 139.24–5).

A related point, expressed by ASFA, is that the compulsory nature of superannuation requires a statutory complaints body to maintain confidence in that policy. It said:

> … ASFA strongly supports the continued role of a statutory complaints body (such as the SCT). ASFA regards this as an essential element to maintain public confidence in compulsory contributions – a key element in the government's retirement income strategy. (sub. 15, p. 23)

A similar view was expressed by Jacques Martin (sub. DR62, p. 28).

Such compulsion occurs elsewhere in the financial sector — for example, with respect to some insurance — without public confidence in the policy being called into question by the non-statutory nature of the external complaints resolution scheme which deals with their complaints.

In recent years, while criticisms have been made of appointments to external disputes resolution bodies, both industry-based and statutory, their independence has not been questioned. Although the independence of a statutory body may be more readily perceived, the formulation, operation and regulation of industry-based schemes effectively achieves the same result.

Procedures for resolution of complaints

Determinations

The Tribunal has the power to make a determination on a complaint that is binding on the trustee and/or insurer and complainant. A complainant may only take a Tribunal decision to court on questions of law. Decisions of industry-based bodies are binding only on the industry members that have joined the respective schemes, but a complainant may take other courses of action if dissatisfied with a decision of an industry-based body.

As Maurice Blackburn Cashman stated:

> … with [alternative dispute resolution] if you're not happy you can take your case to court. With the SCT you can, but they've got much more limited powers of review. … There is a right of appeal on a question of law to the Federal Court, not on a question of

> fact. But the reality is that it's usually the superannuation fund/insurers who have the bulk of the appeals. (trans., pp. 376, 379)

While it is important for efficient complaints resolution that decisions of the external disputes resolution body be binding on the subscriber fund, in practice there appears to be no particular advantage or disadvantage accruing to the decisions also being binding on the complainant.

Information

The transparency of external complaints resolution is important for ensuring the integrity and accountability of the system and confidence in it. The provision of information is fundamental to this and is a requirement of all external complaints resolution schemes. The Chairman of the Tribunal pointed out that:

> The Tribunal's reporting obligations do represent a benefit to the regulator. Information is not only provided in the Annual Report, but individual breaches of SIS legislation and regulations are required to be reported as they arise, pursuant to the provisions of section 64 of the Complaints Act.
>
> … all Tribunal decisions in an anonymized form are publicly available for review by members of the industry, complainants as well as any other interested parties. The decisions are the subject of regular reporting in industry magazines and legislative commentaries such as CCH. Accordingly, there is much more comprehensive dissemination of information than is the case with industry schemes. (sub. DR60, pp. 2–3)

As Jacques Martin stated:

> … the publication of the determinations and the reasons for reaching the determination … provides a valuable "feedback loop" for trustees in the industry with respect to various industry and fund practices and decisions which would not otherwise be available. (sub. DR62, p. 28)

The Tribunal has indicated that in cases where it makes a decision at a review meeting, it takes approximately 4–8 weeks for the decision and reasons to be written and signed by the Tribunal members (SCT website). However, Maurice Blackburn Cashman noted that there had been 'continuing delays of up to twenty weeks or more in written decisions being published following review meetings' (sub. DR54, p. 4).

Similar information requirements are imposed on all ASIC-regulated external complaints resolution schemes in the financial sector (ASIC 1999a, PS 139.62–77 and 139.83–5). While there is no requirement to publish all determinations, existing industry schemes publish material on cases considered significant, interesting and educative where, as the IEC stated in its tenth annual volume of determinations, they ‘deserve consideration and communication to the wider community’ (IEC 2001b).

Quality of decision-making

An important consideration is the quality of the outcome of the decision-making by industry-operated external disputes resolution schemes compared with that of the Tribunal. Maurice Blackburn Cashman, a practitioner in this area, commented on this question:

> I don’t have a problem with any of them. We wouldn’t recommend the clients to take their complaints to these dispute schemes if we did. … I don’t have a problem with the outcomes. (trans., p. 387–8)

Monetary limits

A number of participants noted that the Tribunal is not constrained by any monetary limits relating to complaints which it can consider. ASFA said that ‘there is no maximum amount for matters to be dealt with by the SCT — this stands in stark contrast to many of the approved complaints resolution schemes which have a monetary cap for complaints’ (sub. DR56, p. 9). All the external disputes resolution schemes operating in the financial services industry have monetary claims limits, which vary from scheme to scheme. However, before ASIC approves an external disputes resolution scheme it reviews its monetary claims limit having regard to the nature, extent and value of consumer transactions in the relevant industry or industries (ASIC 1999a, PS 139.34).

There is no particular reason why an external disputes resolution scheme considering superannuation complaints need have monetary limits; or, at the least, not prescribe low limits that would cause many complaints to be taken to court.

8.4 Assessment

The Resolution of Complaints Act established the Superannuation Complaints Tribunal as part of the rearrangement of the legislative framework for the superannuation industry in 1993. The Tribunal has wide support within the superannuation industry. It operates independently and transparently, and is accountable to Parliament on an annual basis. It also provides useful information to APRA.

The establishment of the Tribunal occurred at a time when industry-based disputes resolution schemes in the financial sector were either non-existent or still in their infancy. A number of industry bodies have now been in operation for around a decade, during which time they have amended and improved their structures and processes. The schemes are now subject to regulatory supervision by ASIC. These guidelines for ASIC approval specify that they '… should promote the harmonisation of minimum standards across complaints schemes operating in the financial system' (ASIC 1999a, PS 139.5). This requires ASIC to apply 'a common set of approved guidelines developed for broad application' (ASIC 1999a, PS 139.13). Thus, an industry-based complaints resolution scheme would not create a problem in terms of inconsistency of treatment of complaints across the financial services sector.

Notwithstanding perceptions in some quarters that the Tribunal is a necessary institution for the resolution of superannuation complaints, industry-based external disputes resolution schemes have many features similar to those of the Tribunal. Equivalent independence has been assured through structural separation between the operational body and the industry and by equal representation on governing boards. The quality of outcomes has not been questioned and industry-based schemes are respected by the financial services industry and complainants. The industry-operated schemes approved by ASIC have a similar requirement to provide information to regulators and the public about their operations.

There are, however, differences between the Tribunal and industry-based schemes. These differences relate to efficiency, flexibility and the structural basis for their operation.

As noted above, the Tribunal has operated well since the question of its constitutional status was resolved. In some respects, though, industry-based schemes operate more efficiently. The more direct and flexible method of financing has created better incentives for the fair and effective resolution of complaints. In addition to annual fees, industry-based schemes (unlike the Tribunal) charge their members according to the number and complexity of complaints handled. Complaints requiring resolution by an adjudicator or panel attract a higher charge than those which can be dealt with by simple negotiation. It could be expected that such a system would result in increased efficiency in processing complaints— with the result that fewer resources would be needed. It creates a strong incentive for industry members to resolve complaints internally or in the early stages of dealing with an external disputes resolution body. Moreover, the Commission is aware that discussions have commenced between the managements of FICS, IEC and the BIO to achieve cost savings by sharing some common 'back office' functions (IEC 2001a).

Industry-based schemes also appear to have an advantage in terms of flexibility of operation. For example, their budgetary processes and charging systems are able to respond better to changes in demand for their services. Similarly, if changes to their terms of reference were needed, they are likely to be effected more quickly than would be the case with changes to the Resolution of Complaints Act, which would be subject to Parliamentary processes.

The FSR Act requires all licensed financial service providers to join an ASIC-approved external disputes resolution scheme. Industry-based schemes may have an advantage in this respect for some service providers (eg. banks) which might prefer to have any type of complaint (whether superannuation-related or not) to be dealt with by their industry scheme.

An added advantage of industry-based schemes is that they are subject to an ASIC requirement for an independent, regular review of their operations and procedures. Any review of the Tribunal's operation would need to be initiated by Parliament.

Against these considerations, the Tribunal has an advantage for complainants in that its legislation imposes no monetary limit on complaints within its jurisdiction. Industry-based schemes have such limits. For example, a BIO award to a complainant cannot exceed an amount of $150 000. As noted above, though, ASIC PS 139 does require any such maximum to be set so that is consistent with the nature, extent and value of consumer transactions in the relevant industry or industries.

Any change from the existing arrangements for resolution of superannuation complaints would involve transitional costs. In particular, there would be implementation costs given the need for suitably licensed disputes resolution bodies to develop the necessary capacity, and for trustees of superannuation funds to become familiar with such bodies. Minor amendments would also need to be made to member information booklets and other communication material.

There could also be redundancy costs if the Tribunal was eventually closed, although complaints would still need to be dealt with elsewhere. This would limit the reduction in employment in disputes resolution activity. One way of minimising the transitional costs would be to provide for a phased period of, say, one year, in which trustees of funds could opt to join an approved disputes resolution body (to which their members' complaints would be directed). At the end of the one-year phasing period, all funds would be required to have joined an approved disputes resolution body. In the event that superannuation matters were taken up by an existing industry-operated scheme, there would be an opportunity for economies of scale and scope to be gained by spreading overhead costs across increased throughput.

There are clearly advantages and disadvantages associated with any change to the present arrangement for external resolution of superannuation complaints. Industry-based schemes can provide a viable and efficient alternative to a statutory-based body. The Commission, on the balance of the arguments, considers that the Resolution of Complaints Act should be repealed.

RECOMMENDATION 8.2

The Superannuation (Resolution of Complaints) Act 1993 should be repealed, subject to some transitional arrangements.

All superannuation entities regulated by the Australian Prudential Regulation Authority should be required to join a disputes resolution scheme approved by the Australian Securities and Investments Commission. This should be mandated as part of the compliance requirements of those superannuation entities.

The Commission does not see that there is a need to be prescriptive about which disputes resolution scheme superannuation entities should join, other than that funds should join an appropriately licensed body. This is consistent with the provisions contained in the FSR Act and in PS 139, which would promote consistency among such schemes across the financial services sector.

If this recommendation was adopted, the Tribunal would not be precluded from seeking to re-establish itself as an approved alternative disputes resolution scheme with funding being provided directly by industry.

If the above recommendation was not accepted, then the Commission considers that some aspects of the operations of the Tribunal should be modified.

8.5 Possible modifications to Tribunal

Aspects of the operation of the Tribunal could be modified in order to achieve efficiencies and gain some cost reductions. These include adoption of a more incentive-based system of charging for its resolution of complaints; introduction of a lodgment fee for complainants; extension of the statutory time limit for consideration of appeals on disability payments; and the naming of superannuation entities subject to complaints handled by review. These are discussed below.

Charging for complaints resolution

The Tribunal does not charge superannuation entities or complainants directly for its services. These are financed indirectly via the APRA levy on all regulated funds.

This means that the actual cost of dealing with a complaint is hidden from the parties involved. As a result, there is reduced incentive for superannuation fund trustees to limit their use of the Tribunal's resources. A more direct system of charging funds for use of the Tribunal's resources would have advantages in terms of enhancing the efficiency of its resolution of superannuation complaints.

Lodgment fee

A high proportion of written complaints made to the Tribunal are outside its jurisdiction. In 2000-01, nearly 40 per cent of complaints that were outside the Tribunal's jurisdiction, were excluded because the complainant had not first approached a fund's internal disputes process (SCT 2001a). This indicates there may be scope to introduce measures to reduce the number of such complaints, thus avoiding the need to divert Tribunal resources to deal with them. One way of achieving this could be to introduce a lodgment fee that could be refunded if the complaint is upheld. The advantage of this approach is that it would encourage complainants to prepare carefully before submitting a complaint and to reduce the Tribunal's costs, with eventual benefits for members of superannuation entities that are levied to finance it.

The Chairperson of the Tribunal has commented that in many cases where a total and permanent disablement benefit has been refused, or in the case of disagreement with a death benefit distribution, a fee might not be effective as it is unlikely that a fee would be imposed or there would be a claim for an exemption. Further, the Tribunal commented that the imposition of a fee may be administratively time-consuming and in order 'to be cost effective in terms of added administration, a fee needs to be substantial' (sub. 40, pp. 1–2).

A feature of all industry-based disputes resolution bodies is that they provide low-cost access to consumers. The ASIC guidelines advocate that access should be available to complainants free of charge in order to promote equity and that, if it is proposed to charge, certain conditions should be met, including public consultation with industry, consumer organisations and ASIC before the proposal is implemented (ASIC 1999a, PS 139.43–5).

In view of ASIC guidelines on this question, the desirability of ensuring consistency with the practice of other industry-based disputes bodies operating in the financial sector and the lack of comment or support by participants to the inquiry, the Commission considers that it would not be appropriate to impose a lodgment fee for complainants.

Extend statutory time limit

The Tribunal has no discretion to extend beyond one year the time limit for complaints against a trustee's decision on disability payments. Problems arise, for example, where medical evidence may not be available to the Tribunal within the specified period. There might be some circumstances that warrant an extension of this limit in order to ensure that a fund member's interests are treated properly by the complaint mechanism.

There was limited comment on this by participants. Those who did comment expressed general support for the recommendation.

The Commission is aware of a proposed new bill to amend the *Financial Sector Legislation Amendment Act 2001* to empower the Tribunal, at its discretion, to deal with total and permanent disability complaints outside the time limits prescribed in the Resolution of Complaints Act. This would be in line with the Commission's recommendation. The proposed Bill would also require the Tribunal to formulate written guidelines indicating the kind of circumstances in which it would ordinarily exercise this discretion.

Naming certain funds

A suggestion was made by Dr Horr, a participant in the inquiry, that complaints handled by the Tribunal after review should list the name of the superannuation fund, as occurs in Federal Court decisions. This 'would make complaints easier to resolve if the person making the complaint can review past interpretations by the [Tribunal] of a particular superannuation company's trust deed and rules' (sub. 5, p. 1). Dr Horr also argued that 'the individual is clearly severely disadvantaged with no past relevant cases to review while the superannuation company knows all this information from its case studies' (sub. DR73, p. 1). Naming of funds could have the advantage of encouraging resolution of complaints at the internal stage, thereby avoiding some costs.

As a result of the secrecy provisions contained in section 63 of the Act, the Tribunal is unable to name individual complainants and/or trustees or insurers. However, the Chairperson of the Tribunal has indicated that the industry has been put on notice 'that where there had been a consistent failure by a particular trustee or insurer to adhere to acceptable standards, then I may be obliged to name that trustee/insurer in the Annual Report' (sub. 40, p. 2). To date, he has not considered such action to be necessary. Further, he has told the Commission that the naming of particular funds could present a distorted picture as the Tribunal only deals with a small proportion of complaints compared with the large number of claims that may be dealt with satisfactorily by a fund under its internal procedures.

Most participants who commented on this issue did not support the naming of funds. Reasons advanced included that it raises confidentiality issues and that it could provide a misleading picture of a fund's overall performance in dealing with complaints. The larger funds would bear the greatest risk of being named because of the scale of their operations rather than their relative effectiveness. Some considered that the proposal by the Tribunal's Chairman to name funds for persistent failures in its annual report would be a more appropriate approach. The Commission notes that industry-based disputes resolution bodies in the financial sector do not currently name firms in the publication of their determinations, but that this will be an issue to which some future consideration will be given.

The Commission generally supports the principle of transparency, but considers that the Tribunal's comments on this issue have validity. However, it considers that the Chairperson should have the ability, if and when it is considered appropriate, to name funds.

In the event that the Resolution of Complaints Act is not repealed, the Commission considers that:

RECOMMENDATION 8.3

The Superannuation (Resolution of Complaints) Act 1993 should be amended for the following purposes:

- ***to enable the Superannuation Complaints Tribunal to implement an incentive-based system of charging superannuation entities for its resolution of complaints;***
- ***to give the Tribunal discretion to extend beyond one year the time limit for its decision on complaints against trustees' actions on disability payments; and***
- ***to give the Chairperson of the Tribunal discretion to name parties to complaints reviewed by it.***

9 Other legislation under review

The Commission reviews, in this chapter, the four other Acts contained in the terms of reference.

The Superannuation (Financial Assistance Funding) Levy Act provides for the imposition of a levy on APRA-regulated superannuation entities to recoup the costs of providing financial assistance to a fund which has incurred a substantial loss as a result of fraudulent conduct or theft. Part 23 of the SIS Act provides for assistance to be given in such circumstances, where the Minister considers it to be in the public interest. The Commission considers that the Levy Act, and part 23 of the SIS Act, are appropriate for this purpose. In the interests of transparency and accountability, it recommends that the Minister be required to present to Parliament the reasons for a decision to grant assistance and advice received from APRA.

The Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition Act and the Superannuation (Self Managed Superannuation Funds) Taxation Act impose a levy on self-managed superannuation funds for their regulatory supervision by the ATO. The Commission assesses that the legislation is necessary for this purpose.

The Occupational Superannuation Standards Regulation Application Act was enacted to overcome uncertainty at the time about the validity of regulations made under previous legislation (that was the forerunner to the SIS Act) in relation to Superannuation Guarantee arrangements. The Commission recommends that the Act be repealed as it is no longer relevant.

As part of this inquiry, the Commission was asked to review four other Acts. These are:

- *Superannuation (Financial Assistance Funding) Levy Act 1993*;
- *Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition Act 1991*;
- *Superannuation (Self Managed Superannuation Funds) Taxation Act 1987*; and

- *Occupational Superannuation Standards Regulations Application Act 1992*.

The Superannuation (Financial Assistance Funding) Levy Act forms part of the arrangements for providing assistance to funds in some failure situations. The Act is evaluated in the context of those arrangements in the next section. The following section contains the review of the Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition and Taxation Acts, which provide for the funding of the supervision of self-managed superannuation funds (SMSFs) by the ATO. In the final section is the review of the Occupational Superannuation Standards Regulations Application Act.

9.1 Providing for financial assistance in some 'failure' situations

Background

Failure of a superannuation entity can have serious implications — particularly for older members who are dependent on the fund for an income and those with significant savings in the fund. Such people have limited opportunities to rebuild their savings and may have to rely on the general social security safety net, including the means-tested age pension.

Part 23 of the SIS Act allows the Commonwealth Government to grant assistance to APRA-regulated superannuation entities that have suffered loss as a result of fraudulent conduct or theft. This assistance can be recouped by the Government through the imposition of a levy on superannuation funds and approved deposit funds. The *Superannuation (Financial Assistance Funding) Levy Act 1993* (hereafter called the Levy Act) imposes this levy. The administration provisions relating to the levy are contained in the *Financial Institutions Levies Collection Act 1998*, which is not under reference in this review.

The Levy Act

To invoke the Levy Act, the Minister must first make a determination under part 23 of the SIS Act. The Levy Act prescribes that the levy imposed must not exceed 0.05 per cent of the sum of the values of all the assets of the levied funds at the end of the previous financial year and may be set at different rates for different classes of funds.

The maximum levy of 0.05 per cent seems adequate to cover most potential losses due to fraud or theft. Given the assets currently held by eligible superannuation entities, the maximum levy could provide for more than $250 million in assistance. In June 2001, the average size of a regulated superannuation entity was $107 million (excluding SMSFs and small APRA funds). The Senate Select Committee on Superannuation and Financial Services has reported that, over the past ten years or so, total losses as a result of fraud or theft were in the order of $20–$30 million (SSCSFS 2001a, p. 33).

Consideration of the competition and cost impacts of the Levy Act should have regard to its role in providing financial assistance under part 23 of the SIS Act.

Part 23 of the SIS Act

Under part 23 of the SIS Act, the trustee of a fund can apply to the Minister for the grant of financial assistance for the fund if:

- a fund suffers an eligible loss; and
- the loss has caused substantial diminution of the fund, leading to difficulties in the payment of benefits.

An eligible loss is one suffered by a fund as a result of fraudulent conduct or theft. It does not include the consequences of poor investment choices.

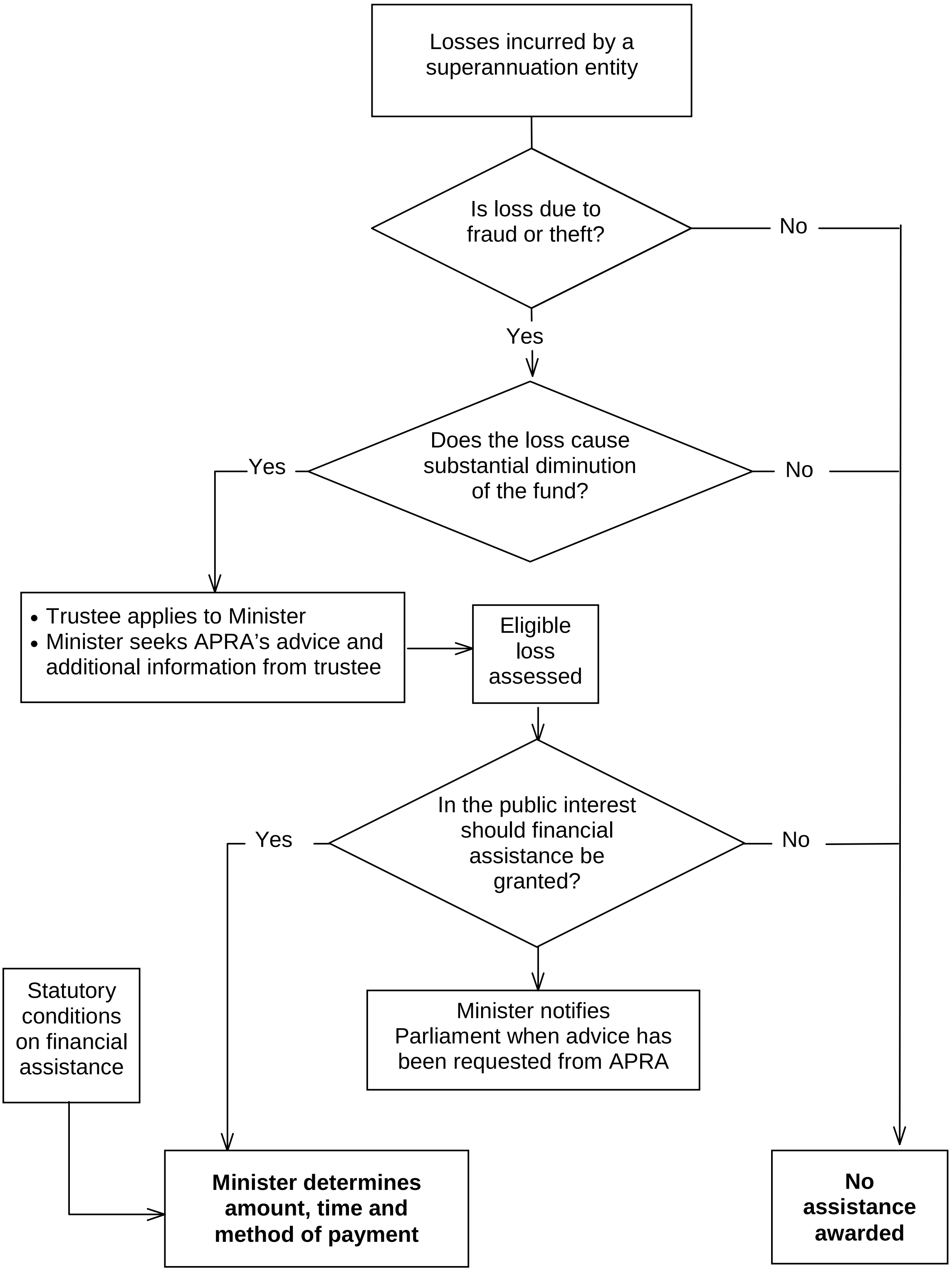
The process of awarding financial assistance is illustrated in figure 9.1. Upon the receipt of the trustee's written application for assistance, the Minister must seek advice from APRA regarding the case. If satisfied that there has been an eligible loss, the Minister must determine whether the public interest requires the grant of financial assistance and, if so, the amount of that assistance and the manner and timing of its payment. Upon reaching a decision, the Minister must also table in both houses of Parliament, as soon as practicable, the written request made to APRA for advice about the matter. The Minister, however, is not required to table the advice provided by APRA, or the reasons why assistance is or is not in the public interest.

Conditions of financial assistance

The SIS Act sets out several conditions for the payment of financial assistance:

- the amount of financial assistance granted must be less than the assessed eligible loss suffered by the fund;
- the money must be deposited into the corpus of the fund and must be applied within a period determined by the Minister;

Figure 9.1 **Awarding financial assistance**



- the trustee must prepare and give the Minister reports on the application of the assistance, as required by the Minister; and
- a fund which has received financial assistance may be required to repay to the Commonwealth that assistance, or part thereof, if a condition of receiving the grant has been breached. The amount repayable to the Commonwealth has priority over all other debts.

The Government has not provided financial assistance under part 23 of the SIS Act to date, and has not invoked the Levy Act. However, the Government has recently received requests for financial assistance from a few funds that have suffered losses. These are currently being evaluated.

Objectives and benefits

The objective of part 23 of the SIS Act is to assist superannuation funds which are unable to pay member benefits as a result of fraud or theft, when the Minister considers that it is in the public interest to assist them. The direct beneficiaries of the assistance are members of such funds. The rationale for providing such assistance derives from the assessment that, while prudential supervision of funds for compliance with the SIS legislation is, among other things, aimed at reducing the risk of fund failure, it cannot eliminate that possibility. Members of complying funds typically bear some involuntary risks as a result of the lack of choice in the placement of compulsory, long-term savings made on their behalf.

The objective of the Levy Act is to share the cost of providing the assistance among complying, prudentially-regulated funds.

The cap on the amount of assistance that can be raised under the Levy Act, and the requirement for a public interest test under the SIS Act, place limits on the provision of such assistance.

The Institute of Chartered Accountants in Australia supported the Levy Act and said that it sees ‘the present provisions as suitable to meet industry’s current requirements to protect innocent members while not adversely impacting all members’ (sub. 9, p. 9).

Participants also acknowledged that, given the low incidence of failures in the past, the current system seemed cost effective, flexible and allowed some degree of discretion. The Australian Institute of Superannuation Trustees said that it is ‘appropriate to have some sort of mechanism to deal with this issue. The levy approach is preferable as it provides some degree of discretion’ (sub. 19, part 2, p. 5). The Association of Superannuation Funds of Australia (ASFA) ‘considers the current arrangement to be the most appropriate on both cost and moral hazard grounds' (sub. 15, p. 24).

Costs

As financial assistance under part 23 of the SIS Act has not been provided to date, it is difficult to assess the associated costs of the Levy Act. If the Levy Act were invoked, added costs would be imposed on superannuation funds, and ultimately their members, in the nature of a transfer from fund members as a whole to the members of the fund which failed.

A risk involved in providing financial assistance to those who have lost retirement income savings is that it may provide false assurances to members that all funds are effectively guaranteed. Furthermore, it could be argued that the existence of this levy might lead to less vigilance in monitoring for fraud or theft by trustees and members who believe that superannuation funds are protected from losses. This potential 'moral hazard' problem may lead to more fraudulent activity and failure of superannuation funds than might otherwise occur in the absence of such provisions. However, given the low incidence of funds that have suffered losses as a result of fraud or theft since 1993, any moral hazard problem appears to be minimal.

Alternatives

As an alternative to the current ex post financial assistance levy, the Commission raised the possibility in its Issues Paper of an ex ante levy to finance a fidelity fund which could be drawn on when such assistance was required. Creating an industry fidelity fund, however, is not without its own difficulties — in particular, the opportunity cost to members of funds which contribute to it.

It was not favoured by participants, who highlighted the low incidence of loss in the past and noted that that contributions to a fidelity fund would create a pool of money which, in all likelihood, would be used infrequently, yet would impose significant costs on current members. As stated by ASFA, '[if] history is a guide to the future, then it could be argued that the industry would be incurring an expense to meet a contingency that will never rise' (sub. 15, p. 23). PricewaterhouseCoopers also noted:

> … whilst this Levy Act has not been used yet, establishing a fidelity fund as an alternative was unwarranted and would add unnecessary complexity to the existing system. (sub. 14, p. 16)

Another alternative would be to require superannuation funds to insure against the risk of such losses. This would shift costs and risks to the private sector and, in effect, replace a contingent liability on funds with ongoing insurance premiums.

The Commission believes that fidelity fund contributions or insurance premiums would be a more costly way of achieving the objective of the legislation than the present levy arrangement, given the low incidence of loss as a result of fraud or theft.

Participants' response to the draft report

In the draft report, the Commission assessed the provisions to award financial assistance to funds, in circumstances of loss as a result of fraud or theft, as being appropriate. The Commission noted that there were no guidelines specified for the public interest test and considered that, while this may create some uncertainty, it was appropriate given the difficulty of specifying guidelines applicable to all circumstances. This provides the Minister with substantial discretion in awarding financial assistance. The Commission recommended that the process of awarding assistance be subject to greater transparency by requiring the Minister to table APRA's advice and the reasons for the Minister's decision on whether to provide financial assistance.

Participants generally supported the current legislation to provide assistance and greater transparency in its provision. Trustee Corporations Association of Australia said:

> The Association supports the concept of maximum transparency in the granting of financial assistance by Government to a superannuation fund that suffers a significant loss as a result of theft or fraud. We also believe that the relevant information should be made public as soon as practicable. (sub. DR69, p. 6)

While Jacques Martin Industry Funds Administration Pty Ltd supported the current legislation, it noted the potential consequences of requiring APRA's advice and the Minister's reasoning to be tabled:

> We support the current legislation and note that the conditions precedent … appear to ensure that financial assistance would be granted in appropriate circumstances.
>
> While we support the principle of transparency, we would submit that, on balance, requiring APRA's advice, and the reasons for the Minister's decision, to be tabled in parliament could have a number of consequences. It could result in significant adverse publicity for the affected fund, damage public confidence in superannuation, provide information as to how the fraud or theft was perpetrated, unnecessarily restrict the disclosure of information, and the giving of advice, by APRA to the Minister and generally impede the decision-making process. (sub. DR62, pp. 35–6)

ASFA supported transparency, but also sought a review of the operation of part 23 of the SIS Act on the ground that 'the trigger mechanism for financial assistance is uncertain' (sub. DR56, p. 11). Similarly, the Institute of Chartered Accountants in Australia sought an expansion of the Commission's draft recommendation 'to require the criteria for this part to take effect to be clearly stated to avoid uncertainty about the provisions and when they are to be utilised' (sub. DR61, p. 4).

Assessment

The issue of financial failure among prudentially regulated entities was canvassed by the Wallis Committee (FSI 1997). It held that:

> … prudential regulation involves responsibility not only for constraining the risk of institutional failure but also for resolving failure where it does occur. Indeed, resolution of failure is one of the main functions of prudential regulation, particularly where financial promises are most intense. (p. 352)

In reviewing the particular arrangements that applied (and still apply) for superannuation, the Wallis Committee endorsed current arrangements permitting the prudential regulators to replace fund managers, trustees, auditors and actuaries and for the Treasurer, on advice from the prudential regulator, to levy the industry up to 0.05 per cent of assets to make assistance where there has been significant fraud and assistance is considered to be in the national interest (FSI 1997, pp. 358-9). It considered that any assistance should not extend to poor investment decisions. Any such extension of assistance would raise intractable 'moral hazard' problems.

The Commission considers that the existing provisions in the Levy Act and part 23 of the SIS Act for dealing with losses incurred by an APRA-regulated fund, as a result of fraud or theft, should continue. Providing financial assistance and financing that assistance by a levy on all eligible funds is justified on equity grounds of sharing losses which would otherwise be incurred by members of prudentially-regulated funds adversely affected by fraudulent conduct or theft. The arrangement is also likely to be cost-effective.

Notwithstanding the views of some that there should be more explicit guidelines, the Commission considers that the existing legislative requirements are clear and that the lack of explicit guidelines in the application of a public interest criterion provides for appropriate flexibility, given the difficulty of specifying in the legislation guidelines that would be applicable in all circumstances.

The Commission believes that the process of deciding whether to grant financial assistance in the event of fraud or theft should be more transparent. The SIS Act requires the Minister to seek advice from APRA when considering a request for financial assistance, and to table that request for advice in the Parliament. It does not require APRA's advice, or the reasons for the Minister's decision, to be tabled. Therefore, the Commission recommends amendment of part 23 of SIS to require the tabling of APRA's advice and the reasons for the Minister's decision.

RECOMMENDATION 9.1

Part 23 of the Superannuation Industry (Supervision) Act 1993 should be amended to require the Minister to table in Parliament, as soon as practicable, the Australian Prudential Regulation Authority's advice and the reasons for the Minister's decision on whether to provide financial assistance to funds which suffer significant loss from theft or fraud.

9.2 Funding supervision of self-managed superannuation funds

Background

The *Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition Act 1991* imposes a levy on trustees of SMSFs, on lodgment of their annual returns, to finance their supervision by the ATO. The levy consists of two components — a basic levy amount and, where applicable, a late lodgment amount if the annual return is late. The *Superannuation (Self Managed Superannuation Funds) Taxation Act 1987* specifies the collection mechanism for the levy on SMSFs, such as the when the levy is payable. The associated regulations also specify a penalty for the late payment of the levy.

SMSFs are funds with fewer than five members where all members are trustees, all trustees are members, no member is an employee of another member (unless related) and the trustee does not receive remuneration for its services as a trustee. As with other superannuation funds, when setting up a SMSF, the trustees must elect to be regulated under the SIS Act if the fund is to receive concessional taxation treatment.

The ATO became responsible for supervising SMSFs in October 1999. From 1999-00, all SMSFs are required to lodge one combined income tax and compliance return with the ATO.

The role of the ATO

Within the ATO, the regulatory supervision of SMSFs is undertaken by the Superannuation Business Branch. The Branch monitors and enforces compliance by SMSFs with the relevant provisions of the SIS legislation. The ATO charges SMSFs a flat rate of $45 a year per fund for their supervision. This involves processing returns, investigating funds, educating trustees and, if necessary, enforcing compliance with the SIS Act. The Superannuation Business Branch also administers the Superannuation Guarantee, the Superannuation Holding Accounts Reserve and the Lost Members Register, although the SMSF levy does not fund those functions.

SMSF levy

The SMSF levy is payable to the ATO at the same time as the fund's combined annual income tax and SIS Act compliance returns is lodged. The money is paid into consolidated revenue. In 1999-00, $8.1 million was raised by the ATO from levies imposed on SMSFs (ASFA 1999, p. 12).

The SMSF levy has been changed a number of times since 1987 (table 9.1). Prior to 1991, small superannuation funds were charged a flat rate of $30 (1987 to 1989) and $40 (1990). Between 1991 and 1998, a variable levy was charged, subject to a specified maximum.

Table 9.1 **Basic levy for self-managed superannuation funds**

Time period	*Basic levy*
1987-1989	Flat $30
1990	Flat $40
1991	$40 per $0.5 million of assets or part thereof (max. levy $5000)
1992-1998	$200 per $0.5 million of assets or part thereof (max. levy $14 000)
1999-2001	Flat $45

Source: ATO (2001a).

Failure to lodge the fund's annual return and/or pay the levy by the due date of nine months after the end of the financial year may result in liability for a late lodgment amount and/or a late payment penalty (table 9.2). These penalties are cumulative.

Table 9.2 **Late lodgment amount**

Time period	*Penalty*
1987-1990	Lesser of $200 or $5 a month
1991-1998	Greater of 20% per annum of basic levy calculated monthly or 0.125 of minimum basic levy
1999-2001	$10 a month

Source: ATO (2001b).

Objectives and benefits

The Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition and Taxation Acts provide the mechanism for raising funds from SMSFs to finance their supervision. The benefits of the Acts derive from their contribution to the funding of that supervision by those directly subject to it. The supervision is required to provide added assurance that SMSFs are established and operated in accordance with the retirement income and revenue protection provisions of the SIS Act. By doing so, the SMSFs are eligible for concessional tax treatment which benefits fund members in providing for their retirement.

Costs

The costs of the Superannuation (Self Managed Superannuation Funds) Supervisory Levy Imposition and Taxation Acts derive from the administration costs incurred by the ATO in collecting the levy and compliance costs incurred by the SMSFs in preparing the appropriate accounts, having them audited and paying the levy on time. For fund members, they are the counterpart to the benefits which stem from the legislation.

Alternative

The only practical alternative to the present means of recovering the costs of regulating SMSFs would be to use budget funding. Although the prudential supervision of superannuation, in general, instils public confidence in the system and has benefits for the wider community, the supervision of SMSFs is unlikely to contribute greatly to these benefits. It is the members of SMSFs who benefit directly from supervision by the ATO. SMSFs have different risk characteristics and pose different regulatory issues than other superannuation entities. Furthermore, the costs of this regulatory task for SMSFs can be readily identified and separated from the costs associated with supervision of other types of funds. It is appropriate that their supervision be paid for by their members.

Participants' response to the draft report

Few participants commented on the Commission's endorsement of full cost recovery for the supervision of SMSFs by the ATO. Those that did comment, supported the Commission's finding. Trustee Corporations Association of Australia said:

> The Association agrees that the supervision of SMSFs by the ATO and of SAFs [small APRA funds] by APRA should be funded separately and be based on full cost recovery. Further, both ATO and APRA should publish the costing of that supervision. (sub. DR69, p. 7)

Assessment

The financial sector has largely been subject to a regulatory system which recovers costs from those subject to it. When the supervisory levies on superannuation funds were introduced, the Government stated that 'it was fair that superannuation funds, and indirectly their members, should bear the full cost of supervising their access to taxation concessions, rather than having that cost borne by the general tax payers' (sub. 8 to PC 2001, p. 4).

More recently, the Wallis Committee endorsed cost recovery for financial regulation:

> The regulatory agencies should collect from the financial entities which they regulate enough revenue to fund themselves, but not more. As far as practicable, the regulatory agencies should charge each financial entity for direct services provided, and levy sectors of industry to meet the general costs of their regulation. (FSI 1997, p. 532)

The main Commonwealth financial regulators of superannuation entities, APRA and ASIC, are both financed from cost recovery levies. The Productivity Commission's inquiry into cost recovery examined the arrangements for both APRA and ASIC and endorsed the principles of cost recovery in accordance with common guidelines for all regulatory arrangements (PC 2001).

The Commission considers that the principle of recovery of the costs of regulatory supervision within the financial sector is sound and that it is appropriate to impose a levy on SMSFs which recovers the associated costs. In this manner, pressure is maintained within the sector to seek an appropriate level of regulatory supervision and for it to be provided in a cost-effective manner.

The SMSF levy is currently set at $45 per annum. In its submission to the Commission's Cost Recovery inquiry, ASFA suggested that 'even at this reduced rate the government continued to make a significant profit from levies on such funds' (sub. 8 to PC 2001, p. 4). However, the ATO has indicated that the $45 levy was set at a rate to recover only the additional costs associated with its regulatory supervision of SMSFs. No data are available publicly to assess this.

The first returns from SMSFs to the ATO were due on 31 March 2001. There should be further scope to assess whether the levy is set at an appropriate level when more information on costs associated with processing and dealing with these returns becomes available. The Commission believes that the costing of the ATO's supervision should be fully transparent.

FINDING 9.1

Given the more limited nature of their regulatory supervision, it is appropriate that the supervision of self-managed superannuation funds be funded separately from that of other superannuation entities and be based on full recovery of costs incurred by the Australian Taxation Office in providing that supervision.

RECOMMENDATION 9.2

The Australian Taxation Office should publish the cost components involved in its regulatory supervision of self-managed superannuation funds to ensure public accountability.

9.3 Occupational Superannuation Standards Regulations Application Act

Background

The *Occupational Superannuation Standards Regulations Application Act 1992* (OSSRA Act) was introduced to overcome uncertainty about the validity of certain regulations made under the *Occupational Superannuation Standards Act 1987*. According to the second reading speech, the OSSRA Act was intended to 'provide certainty for employers, fund trustees, employees and the superannuation industry generally, that the superannuation guarantee arrangements are in place as announced' (Beddall 1992, p. 189).

The 'certain regulations' whose validity was in question were amendments to the Occupational Superannuation Standards Regulations 1987 to reflect the

Superannuation Guarantee (Administration) Act 1992 — one element of the Superannuation Guarantee scheme. Specifically, the amendments:

- clarified certain circumstances in which contributions may be accepted by a superannuation fund;
- limited the rate of increase of benefits vested in a member of a fund; and
- established requirements relating to information to be given to an employer contributor and to the regulator.[1]

Uncertainty about the amendments existed because they were made before the Superannuation Guarantee (Administration) Bill had been properly enacted.[2] The OSSRA Act (sec. 3) dealt with the uncertainty by deeming the amendments and the Superannuation Guarantee (Administration) Act to have been enacted in a particular order.

Assessment

The OSSRA Act no longer serves any purpose. The conditions which gave rise to the need for the Act no longer exert any influence over the management and supervision of superannuation funds and it accords no benefits to fund members. Also, it can potentially cause confusion with remnants of the Occupational Superannuation Standards Act which remain necessary to protect the interests of some fund members. As the ATO said:

> The Act is now of little relevance (since the Occupational Superannuation Standards Act and Regulations were repealed on the introduction of the SIS Act and Regulations). (sub. 28, p. 1)

Few participants commented on the Commission's proposal in the draft report that the OSSRA Act should be repealed. Those that did supported the Commission's position.

RECOMMENDATION 9.3

The Occupational Superannuation Standards Regulations Application Act 1992 should be repealed.

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1 The amendments are contained in the Occupational Superannuation Standards Regulations (Amendment) 1992, No. 223.

2 The Explanatory Memorandum to the OSSRA Bill said: 'Due to a clerical error in the Department of the Senate, the Superannuation Guarantee (Administration) Bill was not passed by both Houses of Parliament in identical form and, as a result of this, Royal Assent to the Bill was not sought' (Parliament 1992, p. 1).

APPENDIX

A Conduct of the inquiry

A.1 Introduction

The Commission received a total of 74 submissions during the inquiry — 49 were received prior to the release of the draft report in September 2001 and a further 25 following its release. All submissions are listed in section A.2. In addition, those who provided comment on the draft report at public hearings are shown in section A.3.

Following receipt of the terms of reference, the Commission placed advertisements in metropolitan newspapers and appropriate publications inviting public participation in the inquiry. Information about the inquiry was circulated to people and organisations likely to have an interest in it. The Commission also released an issues paper to assist parties in preparing their submissions. Subsequent information about the progress of the inquiry has been sent to those who have expressed an interest. All of this information has been made available on the Commission's website (http://www.pc.gov.au).

A.2 List of submissions

The following table lists all submissions received over the course of the inquiry. The submissions containing commercial-in-confidence information have been denoted with an asterisk '*' and those received after the release of the draft report have been denoted with 'DR'.

Table A.1 **List of submissions**

Participant	*Sub. no.*
Association of Superannuation Funds of Australia Ltd	15, 34, DR 56
Australian and International Pilots' Association	33
Australian Council of Trade Unions	22, DR 66
Australian Industry Group	6
Australian Institute of Superannuation Trustees	19
Australian Prudential Regulation Authority	36, 49
Australian Retirement Income Streams Association Ltd	21
Australian Taxation Office	28, DR 67
Chalet Custodians Pty Ltd	DR 74
Commonwealth Department of Family and Community Services	44
Corporate Super Association	12, DR 64
Cox, Andrew	7
Finlaysons	17, 46
Fitzpatrick, Nigel	39
Fonte, Joseph	2*
Government Employees Superannuation Board	DR 53, DR 65
Government Superannuation Office, Department of Treasury Qld	41
Horr, Dr Thomas	5, 25, DR 50, DR 70, DR 73
Investment and Financial Services Association Ltd	23, 32, DR 68
Industry Funds Forum	10, DR 57
Institute of Actuaries of Australia	16, DR 55
Institute of Chartered Accountants in Australia	9, 47, DR 61
Jacques Martin Industry Funds Administration Pty Ltd	24, 29, 48, DR 62
Jadeja, Dilip	1*, 35*
Law Institute of Victoria	DR 52
Lewis, Dr Greg	38
McAuley, John	11, 27
Maurice Blackburn Cashman	DR 54
Phillips Fox Actuaries and Consultants Pty Ltd	18, 43
PricewaterhouseCoopers	14, 37, DR 63
Small Independent Superannuation Funds Association Ltd	13, DR 59

(Continued next page)

Table A.1 **(continued)**

Participant	*Sub. no.*
South Australian Government	31
Superannuation Complaints Tribunal	40, DR 60
Swanston, Graham	4*, DR 72
Taylor, Geoff	DR 71
Taylor, David	3,
Timmins, Peter	DR 58
Tower Trust Ltd	20
Towers Perrin	30
Trustee Corporations Association of Australia	26, 42, DR 69
William M Mercer Pty Ltd	8, 45*, DR 51

A.3 Visits

Informal discussions were held with the following interested parties.

Australian Capital Territory

- Australian Taxation Office
- Chief Executive Officer to the Trustee Boards of the Commonwealth Superannuation Scheme and the Public Sector Superannuation Scheme.
- Commonwealth Department of Family and Community Services
- Commonwealth Department of the Treasury
- Secretariat to the Senate Select Committee on Superannuation and Financial Services

New South Wales

- AMP Financial Services
- Association of Superannuation Funds of Australia Ltd
- Australian Institute of Superannuation Trustees
- Australian Prudential Regulation Authority
- Australian Retirement Income Streams Association Ltd
- Australian Securities and Investments Commission

- Blake Dawson Waldron
- BT Funds Management Ltd
- Colonial First State Investment Managers Ltd
- Commonwealth Bank of Australia
- ING Investment Management
- Institute of Actuaries of Australia
- Institute of Chartered Accountants in Australia
- Investment and Financial Services Association Ltd
- Mallesons Stephen Jacques
- New South Wales Premier's Department
- Phillips Fox Actuaries and Consultants Pty Ltd
- Praxis Partners
- Rainmaker Information Services
- SuperRe Pty Ltd
- Trustee Corporations Association of Australia
- William M Mercer Pty Ltd
- Zurich Financial Services Australia Ltd

Victoria

- AMCOR Superannuation
- Australian Institute of Superannuation Trustees
- Australian Retirement Fund
- Australian Retirement Income Streams Association Ltd
- Australian Securities and Investments Commission
- Australian Society of Certified Practising Accountants
- Banking Industry Ombudsman
- Corporate Super Association
- Esso Super
- Financial Industry Complaints Service
- Insurance Enquiries and Complaints
- IFS Fairley (Superannuation Lawyers)

- Institute of Chartered Accountants in Australia
- Jacques Martin Industry Funds Administration Pty Ltd
- Perpetual Trustees
- PricewaterhouseCoopers
- Superannuation Complaints Tribunal
- Victorian Government (Department of Treasury and Finance)

A.4 Public Hearings

Public hearings were held in Sydney and Melbourne during May and October 2001. Those who appeared are listed in table A.2.

Table A.2 **Public hearings**

Date	*Participant*	*Transcript page no.*
Sydney	Association of Superannuation Funds of Australia Ltd	3 – 17
10 May 2001	Institute of Chartered Accountants in Australia	18 – 29
	Institute of Actuaries of Australia	30 – 39
	Small Independent Superannuation Funds Association Ltd	40 – 54
	Australian Shareholders Association Ltd	55 – 67
	Phillips Fox Actuaries and Consultants Pty Ltd	68 – 81
	John McAuley	82 – 88
Melbourne	Corporate Super Association	90 – 113
15 May 2001	Tower Trust Ltd	114 – 120
	Industry Funds Forum	121 – 131
	PricewaterhouseCoopers	132 – 146
	William M Mercer Pty Ltd	147 – 166
	Jacques Martin Industry Funds Administration Pty Ltd	167 – 193
Melbourne	Australian Institute of Superannuation Trustees	195 – 212
16 May 2001	Finlaysons	213 – 226
	Investment and Financial Services Association Ltd	227 – 241

(Continued next page)

Table A.2 **(continued)**

Date	*Participant*	*Transcript page no.*
Sydney	Institute of Actuaries of Australia	243 – 262
25 October 2001	Association of Superannuation Funds of Australia Ltd	263 – 292
	Small Independent Superannuation Funds Association Ltd	293 – 311
	Peter Timmins	312 – 318
	Institute of Chartered Accountants in Australia	319 – 338
Melbourne	Jacques Martin Industry Funds Administration Pty Ltd	340 – 372
30 October 2001	Maurice Blackburn Cashman	373 – 392
	Industry Funds Forum	393 – 407
	William M Mercer Pty Ltd	408 – 425
	PricewaterhouseCoopers	426 – 441
	Law Institute of Victoria	442 – 450
Melbourne	Corporate Super Association	452 – 476
31 October 2001		

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