SUBMISSION TO

Productivity Commission

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

Association of Superannuation Funds of Australia

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Federal Secretariat

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Summary

ASFA supports the current framework of regulation of the superannuation industry, which is centred on trustees and mandates a single responsible entity.

ASFA believes that the 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.

It is ASFA's view that the trustee structure has the advantage over other management structures in that:

- 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.
- Removal of the trustee structure would necessitate a move to a more inflexible prescriptive regulatory regime.

Removal of the trustee structure would inhibit competition as smaller players would be barred and some of the current large players would be unable to participate. (eg industry funds and corporate funds).

Although ASFA supports the framework of legislation, the implementation by the regulators is often quite unsatisfactory. The primary areas of concern, which may increase costs and inhibit competition, are:

- a lack of co-ordination in the regulatory activities of the regulators, and
- differing requirements of the regulators.

Despite strong support for the conceptual basis upon which 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 to superannuation funds.

ASFA supports the requirement that certain tasks be undertaken by a qualified member of a professional body as the SIS Act is recognising the existence of professional standards. Where there is a breach of professional standards the regulator retains the capacity to ban the professional from performing compliance work on superannuation funds.

ASFA considers that, where the trustee is merely delegating a task that could equally be performed 'in house', and the responsibility for ensuring that it is performed in accordance with legislative requirements remains with the trustee, the current supervisory arrangements are appropriate.

ASFA believes that better disclosure on how the regulator intends to apply the penalty provisions is

essential for the industry, particularly where the use of enforceable undertakings and strict liability provisions are involved.

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. The ASFA submission to the High Court (June 1999) outlines our position.

About the Association of Superannuation Fund of Australia ("ASFA")

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Its members, which include corporate, public sector, industry and retail superannuation funds, as well as service providers to those superannuation funds, account for more around 80% of superannuation member accounts and over 80% of the superannuation assets.

The value of total assets in the superannuation system is currently $496 billion, held in approximately 20 million superannuation accounts representing approximately 8 million superannuation fund members.

The Special Nature of Superannuation

The final report of the *Financial System Inquiry*, which considered the regulation of financial products and product providers, contained a comprehensive analysis of the financial system. The analysis was necessary to establish an underlying philosophy of financial regulation on which the Inquiry's findings and recommendations could be based.

The committee considered the characteristics of financial products, the characteristics of financial services and the role of financial institutions, of which superannuation providers are but one. It reviewed the purpose of regulation, considering general market regulation for the purpose of maintaining market integrity, consumer protection and competition, and then regulation for financial safety by looking at the causes of market failure, the role of regulatory assurance and preventative strategies. It then examined the case for regulation for social purposes.

From the analysis a picture emerged of a broad spectrum of products and regulatory requirements. It stretched from deposit taking institutions, which were clear candidates for prudential regulation, to market linked investments such as unit trusts and like products where a risk is accepted by the investor. These latter products, they argued, should be regulated by disclosure of the characteristics of the product offered, not by prudential regulation of the offering institution. With the exception of superannuation, all financial products could be clearly placed somewhere on the spectrum. The committee said of superannuation:

> *The compulsory nature of some superannuation savings, the lack of choice for a large proportion of members, the mandatory long term nature of superannuation and the contribution to superannuation of tax forgone provide a case for prudential regulation of all superannuation funds, even where investors have knowingly accepted market risk. This rationale is complemented by the need for government to regulate the compliance of superannuation funds with retirement policies such as compulsory preservation. However, the regulatory approach will be different, with its focus more on compliance issues and ensuring appropriate risk management practices, than securing creditworthiness.*

The trust structure

The Inquiry's report acknowledged the role played by the trust structure of superannuation funds in

the regulatory structure, stating that prudential regulation of superannuation is necessarily at the lower end of the intensity scale. The report noted that:

> *It is efficient to link prudential regulation of superannuation, where it is required, with regulation to ensure compliance with government retirement income policies, ensuring that superannuation providers face a single regulator and that inspections can be undertaken on a comprehensive basis.*

The analysis of superannuation as a financial product, and the role played by the trust structure, identified the close relationship between trustees and fund members in **self managed funds** and concluded that, because of this close relationship, these entities should not be subject to prudential regulation. The Inquiry concluded that these schemes are conducted entirely at the risk of the beneficiaries and, in relation to financial safety, there should be no regulatory assurance attaching to such schemes.

As self managed superannuation funds are excluded from the Commission's terms of reference, all subsequent references to superannuation funds and the trustee structure ignore these entities unless they are specifically mentioned for the purpose of demonstrating a point or issue.

The trustee system has long been the accepted mechanism for managing superannuation funds both in Australia and throughout the Anglo-American world. ASFA believes that 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.

ASFA believes that maintaining the trustee structure is paramount to the effective operation of the current principle based prudential regulatory regime. It is an effective, well-understood and appropriate governance structure that precludes the trust being operated in the interests of anyone except members and other beneficiaries. A trustee structure has the advantage over other management structures such as managed investment schemes, in that 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. Removal of the trustee structure would necessitate a move to a more inflexible prescriptive regulatory regime.

Objectives of the legislation

> W*hat are the principal benefits of the legislation? How can they be measured? Have past problems declined in significance since the introduction of the legislation? How well does the legislation accommodate technological and other market-driven changes, including product development? How well does the legislation cope with contemporary problems?*

The primary objective of the legislation under review is to ensure that superannuation contributions are well managed and preserved until retirement from the workforce.

Where individuals are encouraged under other legislation to contribute towards their own retirement income, and those contributions are made to superannuation funds, the legislation under review aims to ensure that those contributions are also well managed and preserved until retirement.

The legislation under review does not of itself encourage retirement savings. The encouragement for individuals to contribute towards their own retirement comes primarily from taxation legislation, the review of which is beyond the terms of this inquiry.

While the legislation has coped successfully with the rapid growth in the size of the industry in recent years, it has been less successful in coping with the accompanying changes in society. The inability of the legislation to accommodate current issues such as changing work patterns, technological advancements and new and innovative products reflects the prescriptive nature of the legislation in these areas. Under the current legislative approach, legislation is amended to recognise changes, rather than being framed in a manner that anticipates, and can accommodate, change. These issues are canvassed in more detail later in this submission.

Costs of the legislation

> *What are the costs of compliance and how significant are they? How substantial are the costs of government administration? Is there scope to reduce such direct costs?*
> *Does the legislation restrict competition in any aspect of the superannuation industry? For example, does it deter the entry (or exit) of superannuation funds, other providers of superannuation products, or other service providers such as accountants, auditors or investment managers? Are some types of funds subject to more onerous requirements under the legislation than others?*
> *Is the legislation too prescriptive and unnecessarily complex? If so, what are the main areas of complexity?*

The superannuation industry recognises that there will necessarily be costs associated with compliance with any regulatory regime. The question is one of how best to minimise costs whilst maintaining adequate prudential supervision.

A review of the increasing costs associated with regulation has identified two key issues:

- Fragmentation of regulatory legislation, and
- Distribution of regulatory functions.

Fragmentation of regulatory legislation
The current scheme of regulation of superannuation was contained primarily in the *Superannuation*

Industry (Supervision) Act and accompanying regulations. This body of legislation provided a single reference point for the regulated entities and their providers. Recently, the *Financial Services Reform Bill* (FSRB) and the *Financial Services (Collection of Data) Bill* (FS(CoD)B) have been introduced into parliament. Both bills have significant regulatory impacts on superannuation entities. The impact is even greater where the legislation sets different standards for similar actions.

The growing array of legislation to be referenced in the administration of superannuation increases the complexity of the task. This creates a potential requirement for funds to resort to external experts to both determine and then meet their regulatory requirements. In effect the growing complexity through fragmentation has the potential to restrict entry into the industry by both funds and service providers by increasing the base level of required legislative knowledge and increasing the complexity and cost of the task of maintaining technical knowledge. It also increases the chance of inadvertent non-compliance as the number of statutes to be referenced grows.

Distribution of regulatory functions

Anecdotal evidence suggests that the move from a single regulator, the Insurance and Superannuation Commission, to a multi-regulator regime has increased costs for the industry. The primary cause of the cost increases appears to derive from two areas:

- a lack of co-ordination in the regulatory activities of the regulators, and
- differing requirements of the regulators.

Lack of co-ordination in the regulatory activities

It is not uncommon for both regulators, the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC), to meet with trustees within a short period. Many of the issues covered contain significant areas of overlap, for example the regulator's expectations where the trustee has some functions outsourced**..** Fund trustees incur significant costs in collating the necessary material, gathering board members together, and attending to the regulatory interviews. Funds would argue that a single coordinated visit would achieve each regulator's objectives at a significantly lower cost to the fund, whilst providing the regulators with an enhanced picture, and thus understanding, of the entity under review.

Differing requirements of the regulators

Where similar services are provided to a number of funds by a service provider, inconsistency of approach between the regulators adds to the administration costs of all funds. The problem is most evident in the small funds segment of the market. There is a range of provisions of the SIS Act that are regulated by the both the Australian Taxation Office (ATO) and APRA. The ATO regulates Self Managed Superannuation Funds (SMSFs) while APRA regulates Small APRA Funds (SAFs). The common feature of these funds is the restriction on membership to fewer than five fund members. The differing feature is the requirement for all SMSF fund members to also be a fund trustee while all SAFs must appoint an independent APRA approved trustee.

The requirement for an entity that provides services to both SAFs and SMSFs to deal with two regulators creates an immediate cost. While many provisions of the SIS Act apply equally to both types of small funds, the interpretation of the provision, or the surrounding administrative arrangements, must be determined by reference to the appropriate regulator. ATO and APRA pronouncements on the legislation only have an effect on the entities which they regulate. This

problem extends from common issues on which two opinions must be sought, to administrative functions, such as lodgment of the annual return, where different forms are required and different processes used.

Of particular concern is the situation where a provision of SIS applies to both a SAF and a SMSF. When this occurs the trustee / administrator must look to the appropriate regulator for direction on how the provision is interpreted. Despite the best efforts of the ATO and APRA to maintain consistency, all APRA superannuation circulars currently contain a statement that they do not apply to SMSFs. Where no equivalent circular is issued by the ATO for SMSFs there is an immediate cost incurred by providers in determining, and then applying, the appropriate administrative action for their SMSF clients. It is to be hoped that over time the issuing of circulars and determinations can be better coordinated between the ATO and APRA.

The superannuation industry can see the potential for similar problems arising with licensing requirements under the FSR regime.

Consistency of treatment

In general, all funds are treated equally under the SIS regime. The exception is that approved trustees are required to have (or have guaranteed) a minimum level of net tangible assets. Given the nature of these entities and the business they are conducting, divergence in this area is deemed desirable.

A feature of the regulatory regime is the manner in which it sets standards for fund trustees and for some service providers. In the case of fund trustees and investment managers the standard is a general probity test. Where standards are set for other service providers they are by general reference to professional bodies.

The capacity of some service providers to work in the superannuation industry is regulated by the application of professional standards by the appropriate body. The SIS Act generally only requires the service provider to be professionally accredited leaving the capacity of the individual to meet the standards to the appropriate professional body. This is considered an appropriate threshold test for those wishing to provide specialised professional services to the industry.

For the provision of some services to the industry (for example, investment management), the legislation prescribes set standards about the relationship. It covers issues such as the entering into of a contract which addresses appropriate matters. ASFA believes this method of regulation sets appropriate standards and does not create a barrier to entry for new competitors.

Alternative means of achieving the objectives of the legislation

> *Are there less costly ways of achieving the legislation's objectives?*
> *Should the legislation be restructured such that the enabling Act is confined to guiding principles for regulators, with additional detail contained in regulations?*
> *Could the legislation be less prescriptive by focussing more on its intended outcomes and less on the means of achieving them?*
> *Is there scope for greater reliance on self-regulation, such as industry codes?*

Could an alternative regulatory approach, based, for example, on a managed investments or company governance structure, provide superannuation at lower cost while still maintaining appropriate safeguards?

The managed investment scheme arrangement was introduced to solve a problem. Where there were previously two entities, with uncertain lines of responsibility, the managed investment scheme has introduced the concept of a single responsible entity. Superannuation, through its trust/trustee structure has a single responsible entity – the trustee.

A managed investment scheme structure, through its requirement for capital backing, would put in place a barrier to entry to new competition that does not exist under the current regulatory regime

It is also difficult to see how a managed investment scheme approach would deliver the benefits provided to members that are currently provided by the representative trustee structure.

As argued in detail under the earlier heading *The Special Nature of Superannuation*, the trustee structure is considered the most appropriate for the industry.

As well as being an effective and well-understood governance structure, it also precludes the trust being operated in the interests of anyone except members and other beneficiaries. When this is coupled with the representative trustee structure, it presents a clear advantage over other management structures, such as managed investment schemes where the interests of the entities owners, primarily shareholders, in its capacity to protect the interests of the member investors.

By basing the regulatory framework on the body of common law that exists around trusts and trustees, a principle-based, rather than prescriptive, regulatory regime can be structured. Where prescription is required or desired this can be achieved by legislating exceptions to the trustee's duty under trust law. This provides for more flexible, efficient and less costly regulation and lower compliance costs.

The trustee structure is the only structure that has the capacity to cope with the current wide range of superannuation providers while providing an opportunity for the entry of 'new mutuals' in the future. ASFA believes that the trustee structure is paramount to the provision of an effective and efficient prudential regulatory regime.

ASFA supports retention of the existing trust-based structure for superannuation.

Superannuation Industry (Supervision) Act 1993

General comments on the SIS regime

The World Bank's seminal report, *Averting the Old Age Crisis*, noted that successful retirement income systems relied upon a three pillar approach; a publicly-funded first pillar, a second pillar of occupational schemes and a third pillar of individual savings.

Australia has been lauded internationally for adopting this three-pillar system in its attempt to best ensure a sustainable retirement incomes system. Notably the compulsory and fully-funded second pillar of superannuation has been praised as being current international best practice.

The main legislative mechanism regulating the operation of superannuation funds is the Superannuation Industry (Supervision) Act 1993 ("SIS"). The SIS regime has been in existence since 1 July 1994 and effectively replaced the Occupational Superannuation Standards Act (OSSA) which had been in existence since 1987.

When first established, the SIS regime sought to avoid unnecessary prescription. The framers of this regime sought to establish "principle-based" regulation. In this sense, trustees were to be guided by a set of statutory principles that found their origins in trust law. These obligations include the duty to manage the fund in the best interests of beneficiaries, to be a prudent manager of money and to carry out the trustee responsibilities in a fair and reasonable manner.

A principle-based approach to regulation acknowledges that regulation cannot effectively prescribe or anticipate all potential activities. This permits flexible interpretation and enforcement in a rapidly changing world. The main strength of the SIS regime lies in this principle-based approach and its reliance on the clear, appropriate and well understood principle of trusteeship and the trust structure.

An example of this is the current Australian regulatory regime for superannuation investment. With the absence of onerous controls over investments, such as a cap on foreign investment, or mandated holdings of Government bonds, and the absence of a requirement to provide a set rate of return, except in limited circumstances, the Australian system 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 allows superannuation fund trustees in Australia to better capture the full benefits of the market. This has allowed Australian superannuation funds to achieve far better long term investment returns than funds in many countries with tighter restrictions on investments.

While these advantages and benefits flow from the regulatory framework, the legislative framework itself is only possible because it is based the premise that it is regulating trusts and trustee behaviour.

However, the principle-based approach is in some way compromised because the SIS legislation is required to perform two distinction functions. On one hand, it provides a regulatory framework for the prudential regulation of superannuation funds, while on the other hand it is used as a means of implementation for the government's retirement incomes policy.

The requirement for superannuation funds to comply with operating standards such as the preservation of benefits until retirement or another appropriate triggering event is but one example of this duality of purpose. The objective of keeping the money in the system until members needed it for retirement purposes is solely a retirement incomes policy issue.

The dual purpose of the SIS Act becomes even more obvious when consideration is given to how it interacts with other legislation that could be regarded as important components of the Australian superannuation system. To be eligible for tax concessions, super funds must comply with SIS. Increasingly, the bulk of money in the superannuation system is derived from compulsory

contributions made under the Superannuation Guarantee legislation to SIS regulated complying superannuation funds.

The presence in the SIS Act and other legislation of provisions which are retirement incomes policy driven formed part of the basis for the Wallis Inquiry's conclusion that superannuation products required a different regulatory approach with a focus more on compliance issues and ensuring appropriate risk management practices, than on securing creditworthiness.

Specific areas of comment

Trustee rules

> *Is it appropriate that the SIS Act focuses on trusts as the principal legal structure of superannuation funds? Could other legal structures for superannuation funds be contemplated — for example, incorporated financial institutions that are prudentially supervised under other legislation?.*
> *Are the duties and obligations imposed on trustees warranted or do they involve excessive costs?*
> *Does the requirement for equal representation of employers and members in employer-sponsored funds deliver significant benefits? Does compliance with it involve any unwarranted costs?*
> *Are the requirements relating to trustee appointment and removal appropriate?*

At a fundamental level, the duties and obligations imposed on trustees are warranted. They recognise that trustees are dealing with other peoples' money and that trustees are implementing government retirement incomes policy.

The equal representation rule which applies to employer sponsored funds reinforces these concepts. It recognises that there is a potential for the sponsoring employer's interest to diverge from those of the trustee and the member. Member representation ensures a better alignment of investment policies in the interests of the fund members. Equal representation rules recognise these potential conflicts and address them in an effective manner through the existing trustee structure.

The basic requirement to be a trustee is the possession of a set of competencies. SIS requires certain behaviours from trustees for the fund to be a regulated complying fund. The behaviours covered range from the probity of the individual to the meeting of specific SIS Act requirements. Failure to meet the requirements places the status of the fund itself in jeopardy. ASFA argues that this has the same effect as a strict prescriptive licensing regime.

Like any board of directors, the total skill set of the directors should be considered when assessing competency of the trustee board. SIS operates on the basis that trustees can use specialist advisers and providers where required. Many trustees, in carrying out their duties, seek legal advice prior to making significant decisions. Most would seek appropriate advice in relation to investment. This is viewed as an appropriate manner in which to carry out their duties and facilitates the operation of the 'equal representative' trustee system. ASFA argues that trustees should be able to satisfy the competency requirements for licensing under the *Financial Sector Reform Bill* by carrying out their trustee duties under SIS and retaining appropriately skilled and experienced staff or advisers.

Although not in favour of a licensing regime for individual trustees, ASFA recognises the need for trustees to receive superannuation specific training and education and promotes and provides training to superannuation fund trustees.

To govern funds well, trustees must acquire and maintain a significant level of knowledge about superannuation and their role and responsibilities. Without this it will not be possible to plan, and to engage and monitor the activities of their agents. It will not even be possible to engage the appropriate advisers. Legal defence also relies on trustees being able to demonstrate good governance skills and practices. This is even more crucial under a strict liability penalty regime.

In the Criminal Code the trustees' defence hangs on whether the trustees had a "reasonable belief" that everything was in order. Trustees demonstrate that they could hold such a reasonable belief by providing evidence that they plan ahead, and have established adequate systems for control, supervision, monitoring and reporting of their agents and delegates.

From the moment it took regulatory responsibility for some superannuation activities, ASIC has shown a particular interest in how superannuation funds handle outsourcing of functions. Their particular concern is how funds monitor the compliance of the outsourced functions. They are keen to develop, in conjunction with industry, principles and standards. ASFA supports the notion of guidance for trustees through principles and standards developed jointly by the regulator and industry, and has a range of 'best practice' papers completed and in production mode.

Rules governing operations

> *Which of the requirements governing the operations of superannuation funds (apart from those excluded from the Commission's inquiry) involve significant benefits or costs?*
> *Could some relaxation of requirements on contributor status (such as those relating to age and employment) enable significant cost-savings?*
> *Are the requirements to provide information to the regulators appropriate or unduly costly (especially for small APRA funds)? Is there consistency between these requirements and the requirements in other legislation, such as the Income Tax Assessment Act?*

Despite strong support for the conceptual basis upon which SIS and our superannuation system is premised, superannuation funds are concerned about a creeping prescription and complexity within the SIS regime. While many of the recent and proposed changes to SIS have merit in seeking to address legitimate policy issues (such as the proposed changes regarding superannuation and family law) all too often, there is a suspicion that much legislative reform is driven by either:

- a "lack of faith" in the decision-making capacity of trustees; or
- concerns that superannuation exploitation threatens the Commonwealth's revenue base.

Invariably, policy initiatives developed in response to the above concerns either result in a series of continuing 'adjustments' as unforeseen consequences are worked out of the system, or are difficult and costly in themselves to implement.

Examples of the above are:

- Risk management statements for derivative investments

- Superannuation Contributions Surcharge reporting
- Contributions standards
- Payment standards

To expand on just one of the above points, the restrictions placed on contributions are complex, costly to administer and, one could argue, inconsistent and counter productive. 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. The complex treatment of those in employment but aged over 65 also complicates the administration of the contribution rules.

A comprehensive review of the contribution rules would not only produce cost savings but would represent a policy improvement.

A case could be argued that better consultation between policy makers (generally Treasury) and regulators would overcome many perceived problems, and thus avoid unnecessary complexity and prescription, reduce costs and enhance competition.

The Commission's issues paper makes special mention of SAFs and the requirements to provide information to the regulators. At the outset it must be stated that these funds have elected to be a SAF rather than an ATO regulated SMSF. In making this election, these funds have chosen to pay an approved trustee to do the trustee work and it follows that the same standards, reporting and otherwise, should apply to them as to other APRA regulated funds. It is acknowledged that APRA supervision is risk based and as such it requires regular information provided by trustees to enable it to properly carry out its supervisory duties.

However, there may be areas in which a change in supervisory activity and reporting requirements may reduce costs for SAFs. A distinction can be drawn between a function such as investment activities carried out by an approved trustee in respect of a single SAF, and custodian arrangements put in place by an approved trustee in respect of all its SAFs. In the first case, a requirement to report to the regulator on an individual SAF basis is necessary and warranted. In the second case reporting on an individual SAF basis is repetitive, costly and fails to enhance the regulatory supervision process. It is argued that, in this instance the most appropriate regulatory arrangement would be for the approved trustee to report on the custodian arrangements it uses for the entities it administers and to certify that the custodian has appropriate internal arrangements in place. The process would reduce costs for the trustee/SAF and permit better supervision by the regulator.

The method of supervision of SAFs raises the question of the quantum of the levy on SAFs. As these funds are not directly supervised, but rather indirectly supervised through supervision of their approved trustee, there is a question of whether the supervisory levy has been appropriately determined.

Superannuation providers

Is this approach appropriate? Could the same objectives be attained if some kinds of

providers were supervised instead under other prudential legislation, such as the Managed Investments Act?
Does the SIS Act result in competitive inequality between providers?
Does the exemption of some public sector superannuation schemes raise any issues for this review?
What are the benefits and costs of this differentiated approach?

If industry growth is an indicator of a competitive environment, then the SIS regime has, for the most part, been exceptional in fostering competition. From 1994 to 2001 the number of regulated superannuation funds has grown rapidly from a low base to now number over 210,000. These range from the SMSFs with their direct member trustees (216,907), to corporate funds (2026) ranging from moderate in size to enormous funds run by our largest companies, industry funds (61) with hundreds of thousands of members and to retail superannuation funds (149) operated by major financial institutions. During this period the relative size of each category has also changed in both percentage and actual terms. The figures are evidence of both the incredible diversity and considerable competition within the industry.

With such a wide diversity of product providers it is essential that consumers, the fund members, can purchase superannuation products in the market place with a degree of certainty. This is achieved, in the first instance, by knowing that the providers are being supervised in a consistent manner. This is achieved through supervision of all providers under the one prudential legislation and the standard disclosure requirements that legislation places on all providers.

Public Sector
Although certain public sector superannuation schemes are not covered by the SIS Act, most of these funds act as if they are covered. In some instances these funds have amended the governing statutes to reflect SIS requirements. Where funds cannot be covered by the SIS Act for Constitutional reasons, and they are fully funded accumulation schemes, there are strong incentives for the Commonwealth to encourage 'SIS compliance'. Since such funds are now more likely to outsource their administrative functions to specialist organisations which administer a number of funds (public and private), consistent regulatory rules for all superannuation funds would potentially reduce administrative costs. It would also be less confusing to members/consumers and improve equity among members of all types of funds.

ADFs and PSTs
As special mention has been given to 'approved deposit funds' (ADFs) and 'pooled superannuation trusts' (PSTs) some explanation of the role they play is warranted.

ADFs were first established in response to new taxing arrangements that applied to eligible termination payments (ETPs) paid after 1 July 1983. In many instances members receiving ETPs were unable to meet the immediate rollover requirements which would enable deferment of the ETP tax liability. ADFs were established in response to this market need. They enabled the ETP recipient to 'roll over' the superannuation benefit until retirement, or until they had met the membership requirements of another superannuation fund. ADFs enhanced the operation of the retirement incomes system by providing consumers with an otherwise unavailable opportunity to maximise their retirement income by deferring receipt of an ETP until retirement age. While the growth of the superannuation industry, particularly in the retail area, has addressed this need, some ADFs still

remain.

PSTs are not superannuation funds as such. They are basically a unit trust with a corporate trustee that operates as an investment vehicle for other unrelated superannuation funds. As an investment vehicle, it is operated by an investment manager. It is possible for a PST to meet all the taxation liabilities of investing superannuation funds. PSTs, through their provision of an efficient and tax effective investment mechanism, enhance the operation of the retirement incomes system by lowering costs which may lead to greater retirement incomes**.**

Investment rules

> *Does the SIS legislation, particularly the application of its investment covenants and other investment restrictions, unduly restrict investment strategies, or the investment process, to the detriment of funds' members?*
> *Are the investment provisions in total unduly complex? Could their objectives be better achieved by another approach?*

The current Australian regulatory regime for investments by superannuation entities has many advantages over similar jurisdictions overseas. With the absence of onerous controls over investments such as a cap on foreign investment, or mandated holdings of Government bonds, and the absence of a requirement to provide guaranteed(?) returns, except in limited circumstances, the Australian system 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 allows superannuation fund trustees in Australia to better capture the full benefits of the market. This has allowed Australian superannuation funds to returned far better long term returns than funds in many countries with tighter restrictions on investments.

Restrictions, such as the prohibition on borrowing, the in house asset rules, lending rules and restrictions on purchasing assets from members, they are generally designed to protect members from being placed in a situation of double jeopardy where they can suffer two impacts from the one event. These restrictions are supported by ASFA.

Other rules covering investments, such as the requirement for an investment strategy and the requirement to deal at arms length and to avoid conflicts of interest are principled requirements and as such are supported.

Regulated superannuation service providers

> *What are the benefits and costs of the provisions relating to investment managers and custodians? How necessary are the provisions? Would a different regulatory framework be more effective?*
> *Are compliance audits an efficient means of monitoring compliance with SIS objectives? Do compliance audits reduce the need for surveillance by the regulators? Could the Act's*

The compulsory tier of the Government's retirement incomes policy, the Superannuation Guarantee Charge ("SGC") regime was introduced with effect from 1 July 1992, compelling employers to provide a minimum level of superannuation contributions for employees and certain deemed employees.

The SIS Act contains a comprehensive regime for the regulation of "regulated superannuation funds". It codified the trust law duties of trustees as covenants which are deemed to be included in the governing rules of a superannuation fund regulated under the SIS Act. These covenants are in addition to any obligations which trust law may impose on trustees.

Those codified trust law duties are deemed to be included as covenants in the governing rules of a regulated superannuation fund. Under those covenants, a superannuation trustee is deemed by sub-section 52(2) of the SIS Act to promise:

- to act honestly;
- to exercise the degree of care, skill and diligence of an ordinary prudent person;
- to act in the best interests of beneficiaries;
- to keep fund assets separate;
- not to do anything to impede the proper performance of functions and powers;
- to formulate and give effect to an investment strategy;
- to manage reserves responsibly;
- to allow a beneficiary access to information; and
- to do other prescribed acts.

The interrelationship between superannuation and the Federal Governments' retirement income objectives is further evident from a wide range of other legislation including:

- *Social Security Act* 1991 (Cth) which contains concessional social security treatment for certain superannuation pensions;
- *Bankruptcy Act* 1966 (Cth) which provides that superannuation benefits up to the recipient's pension reasonable benefit limit are not available to be distributed amongst the recipient's creditors on bankruptcy;
- proposed changes to the *Family Law Act* 1975 (Cth) to deal with superannuation on divorce.

The SIS Act, the SGC Act and the other legislation referred to above together make up the complex and comprehensive regulatory framework governing the superannuation industry and ultimately Australia's retirement income system.

The above framework confirms that superannuation is not just operating within 'an area of private law' and as such, it is not an appropriate area for a self-regulatory dispute resolution body such as the financial industry dispute resolution scheme.

As such 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. The ASFA

submission to the High Court (June 1999) outlines our position.

The SCT is funded by an industry levy. In ASFA's view applying a user charge only to those superannuation funds that use the SCT is not appropriate (the decisions of the SCT go to setting standards across the industry). Equally, requiring members pursuing the resolution of matters through the SCT to pay fees is not supported. The Tribunal needs to be independent, affordable and accessible.

Superannuation (Financial Assistance Funding) Levy Act

> *Is it appropriate to make provision for such a levy? Would a legislative requirement that funds contribute to an emergency reserve (fidelity fund) be an alternative?*

The Superannuation (Financial Assistance Funding) Levy Act provides a mechanism for the Commonwealth Government to require the industry to pay a levy where:

- The assets of a superannuation fund are lost or severely depleted, and
- fraud or theft is involved, and
- The Minister deems the matter in the public interest, and
- The Minister determines that the loss should by funded by the levy.

The provisions of the Act have never been used.

It is necessary to distinguish between the levy, which covers fraud and theft, and trustee liability insurance, which covers other acts by a trustee. While it is more likely that loss will occur through areas other than fraud or theft by a trustee, trustee liability insurance is not mandatory but is almost universal.

The difficulty with the Levy Act is the absence of guidelines on the 'public interest' test. Without these guidelines it is difficult to determine the precise circumstances under which the Acts provisions would be invoked.

ASFA considers the establishment of an industry fidelity fund would impose an unnecessary cost on the industry and would create a moral hazard.

The cost would arise from the need for the fidelity fund to both fund an administrative mechanism, and have capital available to meet claims. The fidelity fund would be funded by current members to meet future claims, perhaps at a time when they have withdrawn their funds from the industry. 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 arise.

The moral hazard of a fidelity fund arises through the manner in which human behaviour is driven by surrounding circumstances. The presence of a fidelity fund may result in members being less vigilant in their selection and monitoring of trustees and some trustees being less mindful of their trustee duties and responsibilities.

ASFA considers the current arrangement to be the most appropriate on both cost and moral hazard grounds.

Superannuation (Self Managed Superannuation Funds) Taxation Act and Supervisory Levy Imposition Act

> *To what extent is the purpose to which the levy is put beneficial to self-managed superannuation funds?*
> *Does the amount of the levy appropriately reflect the ATO's cost of supervising self managed funds?*

The quantum of the levy imposed on SMSFs under this legislation was set by Ministerial press release and without an apparent reference to actual costs incurred by the regulator.

The capacity of the regulator to have the quantum adjusted through regulation is a matter of concern as it has the potential to lack transparency. ASFA recommends that any alteration of the levy be done with reference to the actual costs incurred by the regulator in monitoring the compliance of SMSFs with the SIS Act and not with other legislation administered by the regulator.

That the ATO levy is set at $45 brings into question the $300 levy imposed by APRA on SAFs. ASFA has long questioned the appropriateness of a levy of this magnitude on a fund whose activities are controlled and directed by an APRA supervised and APRA approved trustee.

Occupational Superannuation Standards Regulations Application Act

> *Does administration of this Act involve unnecessary administration costs? Would it be appropriate to terminate these provisions?*

The continued operative effect of this legislation raises the issue of the use of grandfathering provisions rather than sunset clauses in legislation.

If deemed appropriate, ASFA would prefer seeing this legislation tidied up or, if possible, repealed.