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ASFA Submission to Taskforce on Reducing the Regulatory Burden on Business

The Association of Superannuation Funds of Australia Ltd (ASFA) is pleased to be able to make this submission to the Taskforce on Reducing the Regulatory Burden on Business ("Regulation Taskforce"), announced by the Prime Minister on 12 October 2005.

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. Our members, which include corporate, public sector, industry and retail superannuation funds, account for more than 5.7 million member accounts and over 80% of superannuation savings.

INDUSTRY EXPERIENCE OF REGULATION

1.1 Regulation and Superannuation

Government regulation has a significant impact on superannuation funds. Superannuation funds are subject to regulation under the *Superannuation Industry (Supervision) Act 1993* ("SIS"), the *Income Tax Assessment Act 1936* ("ITAA") and the *Corporations Act 2001* (in particular Chapter 7 commonly referred to as "Financial Service Reform" or "FSR"). As well, superannuation funds are subject to other superannuation-related regulation such as the *Superannuation Guarantee Administration Act 1992*, the *Family Law Act 1975*, and industrial relations legislation. Superannuation funds are also subject to business-related regulation such as the federal and state Privacy law, non-FSR aspects of the *Corporations Act 2001* (if they are companies) as well as taxes and duties at both the Federal and State level. New laws, such as the proposed anti-money laundering / counter terrorist financing (AML/CTF) reforms, will also impact on superannuation funds.

In addition to legislation, superannuation funds are subject to oversight by a number of regulatory agencies, most notably, the Australian Taxation Office (ATO), the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA).

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Much of this regulation is premised on very sound policy objectives; ensuring that superannuation savings are preserved for retirement, tax concessions are for the purposes intended, appropriate disclosures are made to fund members, those savings are well managed and that consumers are adequately protected. However, in recent times the sheer volume of new law and regulation has been increasing, as has its complexity.

1.2 Cost of Regulation

The regulation of business conduct carries with it compliance costs for superannuation funds – legal costs, staff training, and costs associated with the preparation of policies and disclosure documentation. It has been estimated that FSR implementation, for example, ended up costing superannuation funds about $50,000 each. Spreading these costs across industry it can be estimated that implementing FSR cost the superannuation industry tens of millions of dollars. Similarly, FSR has also increased the cost of advice.

We also estimate that APRA licensing will be even more expensive. The cost of acquiring an APRA license is estimated to be between $100,000 and $200,000 per licence. Given there is expected to be about 350 plus licensees, the overall cost to industry will be between $35 and $70 million. We further expect, that for many funds, the additional costs of complying with APRA licensing, both initially and on an on-going basis, will be considerable.

Superannuation funds also face substantial on-going direct and indirect compliance costs. The establishment of APRA and ASIC has seen a substantial increase in supervisory levies paid by superannuation funds. Despite a substantial decrease in the number of superannuation funds, APRA expenses attributed to superannuation has grown strongly. An unfortunate result of APRA's supervision of HIH and Commercial Nominees (an Approved Trustee for certain superannuation funds) is that superannuation fund member balances are subject to increased APRA levies. These increased levies have had a far greater impact on the level of superannuation assets than any fraud or theft that has ever occurred. It is critical that a clear cost-benefit analysis be done, possibly through the Regulatory Impact Statement process to ensure that the costs of regulatory levies do not overwhelm the benefits.

The costs of complying with the assorted legislation and requirements of the regulators is a serious issue for superannuation funds. Many funds operate on a not-for-profit basis so any cost is borne directly by the members (in the case of accumulation funds) or the sponsoring employer (in the case of a defined benefit fund).

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A specific case of compliance activity where costs are likely to outweigh benefits is the new APRA annual and quarterly reporting requirements for funds. Funds are required to report an immense amount of information using convoluted and poorly explained reporting forms. Little of this collected information is published nor, according to an efficient audit report by the Auditor-General, is this information effectively used once collected.

Recent experience also has led us to further question whether the existing system for assessing the compliance cost of a policy initiative, the Regulatory Impact Statement, adds value in its current form. The costings are not developed with any consultation with industry and often display a lack of understanding of how industry operates. In some cases, costings have been widely off the mark.

Recommendation One: ASFA recommends a review of the current RIS process to ensure genuine and detailed cost / benefits are done prior to undertaking any major reform in the future.

1.3 Use of Regulations and Other Instruments to Amend Legislation

One concern that ASFA has previously raised has been the increasing complexity of legislative design. Increasingly, legislation is supplemented by regulations as well as other instruments and guidance. While ASFA recognises that the use of regulations can often be effective in quickly addressing short-term problems, the resultant regulatory structure can be unnecessarily complex.

To illustrate, as part of completing an APRA Annual Return, the trustees of a superannuation fund must attest to their compliance with particular sections of the *Superannuation Industry (Supervision) Act 1993*, the *Financial Sector (Collection of Data) Act 2001* and the *Corporations Act 2001*. One such section is section 1017D(3A) of the *Corporations Act 2001*. However, when one consults the *Corporations Act 2001*, this section does not appear. Instead, it resides in the *Corporations Regulations 2001*, Schedule 10A, Part 12, Item 12.1. All throughout Schedule 10A there are provisions where sections of the Act are inserted or amended to suit particular circumstances.

A similar practice has been the growing use of legal instruments, such as Class Orders, by ASIC to modify the *Corporations Act 2001*. An example of this is Class Order CO 04/1030, issued on the 14 October 2004. This deals with in-use notices for certain superannuation PDSs and inserts a new section 1015DA into the *Corporations Act 2001*.

There is no cross-reference of these inclusions in any commonly used consolidated version of the *Corporations Act 2001*. As such, a person consulting a consolidated version of the *Corporations Act 2001* available on ComLaw or through CCH would

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not be aware that subsection 1017D(3A) or section 1015DA even existed if they hadn't also consulted the regulations and Class Orders.

While changes to regulations involve Executive Council and are theoretically easier to track, the use of Class Orders is more problematic. In 2004, ASIC issued 86 Class Orders, a rate of nearly one Class Order every four calendar days. Class Orders are available through the ASIC website and the FRLI component of the ComLaw website, however there is no proper indexing and both sites remain difficult to navigate. This effectively requires a person who wishes to follow any possible changes to the law to read through all Class Orders as they are issued.

Recommendation Two: ASFA recommends that the Government:

- **institute a more systemic and timely reform process to ensure that significant changes to the legislation (such as the *Corporations Act 2001*) are incorporated into the main body of the legislation on a regular basis, for instance three or six-monthly; and**
- **ensure that adequate information about such changes is noted within the consolidated version of legislation as maintained on ComLaw.**

1.4 Enforcement and Guidance

Past experience has demonstrated that enforcement action by the regulator can unnecessarily add complexity. A voluntary undertaking secured by ASIC from PrintSuper in early 2004, which outlined supposed detailed disclosure shortcomings and required additional disclosure around the topic of Eligible Rollover Funds, raised concerns within the superannuation industry. While it is hard to see how these additional pages were needed to remedy this claimed particular disclosure breach, the industry's bewilderment was exacerbated by conflicting messages from the regulator. On the one hand, senior ASIC staff reiterated the need for PDSs to be "consumer-centric" and blamed long complex documents on "lawyers". At the same time ASIC enforcement staff were pressuring superannuation funds such as PrintSuper to make lengthy additions to their "deficient" PDSs. A similar incident arose when ASIC secured a voluntary undertaking from Unisuper in November 2004 in respect of its internal complaints handling processes.[1]

In both instances there was considerable confusion as to whether these voluntary undertakings reflected general ASIC standards or were in response to a specific set of

[1] At that time, ASIC issued a media release noting that the undertaking "sends a strong message to the superannuation industry that ASIC views superannuation disclosure and complaints handing obligations seriously". Yet ASIC staff expressed surprise when told specific details of the Unisuper voluntary undertaking (which is publicly available from the ASIC website) were being taken as guidance by industry of ASIC's position on internal complaints handling. These details included the requirement to name a particular complaints officer, a practice which is likely to require frequent updates and may trigger privacy / security concerns for the officer involved.

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facts or circumstances. ASIC has been unclear and at times contradictory on this matter. There was also confusion as to whether the undertakings really were justified, or were more the result of those responsible in ASIC enforcement wanting to demonstrate a result after a surveillance campaign. As well, ASIC appears not appreciate that its use of enforceable undertakings and media releases give rise to negative publicity in regard to the entity concerned and that this may not be commensurate with the severity of the breach ASIC claims has occurred. More care is required in this respect.

Regulators such as ASIC must be crystal clear as to the status of such enforcement activity to ensure that funds understand the relative role played by up-front guidance and enforcement tools. ASFA also believes a regulator must co-ordinate its policy and enforcement staff to ensure internal consistency.

Recommendation Three: ASFA recommends that, where possible, regulators provide up-front guidance, clearly separate from any enforcement activity, and that it interprets and enforces those requirements in a consistent manner. Policy should not be driven by enforcement activity.

1.5 Difficulties in Dealing with Emerging Issues

The existence of multiple regulators in the superannuation space creates its own challenges. One is "ownership" of a new or emerging issue. The superannuation industry has experienced a number of instances of regulatory "orphans" in recent times but we will briefly explore three for purposes of illustration.

Clearing Houses

"Clearing houses" are new service providers that forward superannuation contributions from the employer to superannuation funds. They are a relatively new type of entity/service that has arisen (or has greater prominence/use) as a result of choice of fund. Clearing houses were actively promoted by the Government as a solution to employer concerns over the compliance cost of choice of fund. Yet there has been no co-ordinated "whole of Government" approach to their regulation. Instead, each of the regulators, the ATO, APRA and ASIC, has looked at the issue from the perspective of the laws they administer.

Calculators

Another emerging issue, recently highlighted in the Parliamentary Inquiry into Superannuation for Under 40s, has been the need to provide individuals with information / tools about how much they will have when they retire, a "reality test", given their current savings pattern. These tools can play a critical role in assisting superannuation fund members make important decisions.

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In this regard, the OECD in its recent report *Ageing and Employment Policies: Australia* raised their concern that there is a "general lack of information about the size of future superannuation entitlements" (p. 29). This is consistent with ANOP survey findings which indicate that when pressed about how good an idea the respondent had about likely income in retirement, around 75 per cent of those aged 30 to 39 indicated that they really did not know, with only 8 per cent indicating that they had a good idea. Providing information about future superannuation entitlements based on current behaviours may assist in better informed decision-making by individuals, including decisions to make additional contributions, thus addressing future adequacy. The OECD suggested that Australia adopt a future benefit projection process similar to that used in Sweden. A similar process is mandatory in the UK.

Though superannuation funds have been wanting to make benefit projections or online calculators available to members, efforts in this regard have been frustrated due to the regulatory approach taken by ASIC. Statements from ASIC that online calculators might constitute "financial product advice" and therefore have to be offered under an AFS licence with the associated requirements, led many major financial institutions to remove their calculators from their websites. Only recently, have calculators been re-appearing on a number of sites.

In our view, ASIC has not responded well to an emerging issue. ASIC has let an overly legalistic interpretation of the law overwhelm good policy outcomes. A more open and responsive approach, with ASIC prepared to work with industry on standardised assumptions to be used in calculators, would permit their wider use while ensuring consumers are protected.

Unit Pricing

A positive example of where the regulators have worked together in an emerging area, is in respect of unit pricing. APRA and ASIC worked together to produce a "good practice" paper for industry on unit pricing. This is a better policy response, with a considered document that has the buy-in from both the regulators. Industry has also been consulted on this document and the regulators appear prepared to work with each other going forward on the issue of unit pricing, which has both consumer protection and prudential issues.

The lesson from each example is that the regulators need to be more pro-active – this may require one regulator taking the "lead" on an emerging issue or else agreeing up-front that a joint approach will be taken. To have each regulator just operating within the confines of the law it administers in respect of an emerging issue, may result in future regulatory gaps. As well, both the regulator and the industry benefit from a considered and consultative approach in developing a policy response to an emerging issue.

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Recommendation Four: ASFA recommends that the regulators act pro-actively and regularly communicate and co-ordinate with each other and with industry when responding to an emerging policy issue.

IMPROVING REGULATION

2.1 Improving Policy Development and Implementation

There needs to be an appreciation, at all levels of policy development, that government regulation should ordinarily be a last resort when other alternatives have obvious shortcomings.

Once a decision has been made to address a particular problem through Government policy, then it is imperative that the detailed development of the policy prescription be done in a consultative fashion. An important component of this is to consult closely with industry and affected stakeholders.

Recommendation Five: ASFA recommends detailed consultation with industry regarding practicalities of implementation.

One element that should be considered when developing consumer protection policy is to actually test the proposed policy prescription with real consumers. ASFA has found that consumer comprehension testing is an invaluable tool in this regard, particularly in areas such as fee disclosure. ASIC, in the past, has done some *ad hoc* consumer testing in respect of fee disclosure and has found this useful in understanding and developing policy.

Recommendation Six: ASFA recommends that consumer comprehension testing become a standard part of consumer protection policy development.

2.2 Letting Principle-Based Regulation "Breathe"

Principle-based regulation, such as the FSR, needs to be able to "breathe". Both the regulator and the industry should not rush for "certainty".

Both industry and the regulator may be at fault here. Industry, in particular an industry such as superannuation that has traditionally been used to complying with black letter law, may feel uncomfortable with the freedoms afforded under a principle-based approach and may seek "guidance" from the regulator rather than explore what the law has to offer. Similarly, the regulator may not be able to resist the temptation of launching enforcement action or issuing guidance.

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Ill-considered enforcement (see above) by the regulator may fuel further calls by industry for further "guidance" leading to a downward spiral of more and more prescription.

At times, both industry and the regulator need to resist this fate. Industry needs to be confident that its own justifiable interpretation of the law, made in good faith and within the spirit of the law and policy, will not lead to enforcement action merely because it is different to the interpretation made by the regulator or one of its officers.

2.3 Improving Regulator Competence

One of the major challenges in the regulation of superannuation, and financial services generally, is maintaining regulator competence. Getting the rules right is important but ensuring those who interpret and enforce the rules are able to do so effectively is also important to ensuring quality outcomes.

ASFA has received numerous complaints from superannuation funds about inexperienced ASIC and APRA staff causing difficulties, particularly in the respective licensing processes. Often staff would not be fully aware of the law they were interpreting or have a poor understanding of the industry (including, for example, the increasingly complex disclosure of investments). This could often be compounded by inconsistent views being expressed by different individuals or units within the respective regulators and high levels of staff turnover. Levels of staff turnover within both regulators are a growing concern for industry as a whole and we have heard anecdotally that annual staff turnover within one of the regulators is 30 per cent.

These problems are not divorced from the matter of increasingly complex regulation. As regulation increases in complexity and sheer volume, this drives demand by industry for suitably qualified staff. The superannuation industry, and financial services industry generally, has seen increasing demand for suitably qualified legal, compliance and risk management professionals with a knowledge and understanding of superannuation (including SIS and trust law).

The human resource challenge is a key one for the regulators and Government. There needs to be a greater consideration of how to attract, and importantly retain, quality staff within the regulators, without imposing significant additional costs on industry (through regulatory levies) or the community (through taxation). Strategies of secondment between industry and the regulator may be worthy of consideration.

REGULATORY OVERLAP AND DUPLICATION

3.1 Dual Licensing

Dual licensing and dual regulation of superannuation funds is a challenging area for superannuation funds and the respective regulators. For example, superannuation

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funds must now satisfy both regulators in respect of competency, conflicts of interest, breach reporting and the like. The requirements are similar but in many cases slightly different. This imposes considerable and unnecessary compliance costs on funds, some of which are detailed below.

3.2 Breach Reporting

Superannuation funds have expressed concern that the breach reporting requirements for them as AFS licence holders are different from those expected from them under as the RSE licensing regime under the *Superannuation Industry (Supervision) Act 1993*. Below is a summary of the differences.

	RSE Licensee (APRA)	**AFS Licensee (ASIC)**
Obligations that if breached are reportable	Most limited range of laws but includes risk management strategies and plans	Includes all of legislation reportable by RSE licensee except Financial Institutions Supervisory Levies Collection Act. Also includes other legislation including Superannuation (Resolution of Complaints) Act.
Likely breaches	Not reportable	Reportable but very narrow definition of "likely" in section 912D(1A)
Insignificant or trivial breaches	Reportable	Not reportable
Time to report	As soon as practicable and in any event within 14 days after becoming aware that the breach has occurred.	As soon as practicable, and in any event within 5 business days, of becoming aware of the breach or likely breach.
Content of report	A notice setting out "particulars" of the breach	A report "on the matter"
Offence if fail to report	50 penalty units	50 penalty units or imprisonment for one year or both

Source: Jim Boynton (2005) "What Happens if You Have Got it Wrong? Breach Reporting, Relief Applications and Enforcement Issues" 2005 Superannuation Lawyers Conference, Hobart.

The above table is based on the legislative regime. Administratively, APRA has introduced a *de facto* materiality threshold within the reporting of breaches to the risk management plan or strategy, given that these documents are only to deal with material risks. However, no such materiality threshold exists for reporting of breaches to the range of laws listed.

Leaving aside the issue that APRA's materiality approach only deals with a limited area (risk), APRA introduces the "materiality" threshold at a different point than in the Corporations Act regime. Materiality is established in aspects of the APRA regime when the risks are established and before the breach occurs. In the Corporations Act regime, the breach occurs and then its materiality is determined after the breach occurs. There is an inconsistency in the approaches of the two regulators that creates significant difficulties for the many funds operating in both regimes. In addition, different reporting time frames and different content

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requirements for breach reports create unnecessary inconsistency and impose additional compliance costs.

While ASFA would be very happy to discuss the actual nature of a consistent regime – consistency must be paramount. Ideally any consistent regime would:

- remove the obligation to report "likely", trivial or insignificant breaches at a particular point;
- have a reporting trigger based on knowledge of the breach and determination of its significance;
- have a standard reporting time frame;
- have regard for a standard list of relevant legislation to report breaches of;
- have standardised content for reporting of breaches; and
- have standard penalties.

Recommendation Seven: ASFA recommends that legislative amendments be made to align ASIC and APRA breach reporting requirements.

3.3 Responsible Officer Definitions

There are other areas where APRA and ASIC licensing requirements appear to overlap and have inconsistencies. One is in respect of the competence of the licensee and in particular, who is a "responsible officer" and thus subject to particular competence requirements.

In the SIS Act, a responsible officer is defined as a director, secretary, or executive officer, who is further defined as a person who takes part in the management of the body. This ordinarily includes the trustee board, fund secretary and senior management of the fund secretariat.

In the Corporations Act, "responsible officer" is also used but the definition is different, notably it is an officer of the body who would perform duties in connection with holding the licence. In their interpretation of responsible officer, ASIC has interpreted this as the person who is either directly responsible for the service and/ or holds the competency levels to ensure that the service is offered appropriately. Often this might be a small number of senior staff.

The different definition for the same term in and of itself can create unnecessary confusion. This situation is further confused by the responsible officer under the APRA licence and the ASIC licence being subject to different requirements. In the APRA situation, the licensee must develop a fit and proper policy for all responsible officers. As this has been administered by APRA, this document is to include a needs analysis, developing a training plan for each responsible officer and requiring record-keeping of their training. There are also requirements on the licensee to report to APRA changes to responsible officers.

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ASIC has similar but slightly different requirements. In Policy Statement 164, ASIC focuses on the skill requirements of the responsible officers – generally requiring them to have completed particular courses. However the APRA requirements extend further, focussing on the "character" of the individual. While trustees with both licences appear able to marry the two different approaches, it seems strange that the regulators themselves don't make some effort to have a single set of requirements.

Both ASIC and APRA require responsible officers to provide police checks to the regualtor. Initially APRA intended to permit police checks that superannuation fund trustees had obtained for their licence from ASIC. However it was later found by APRA that these police checks were somehow "deficient" for APRA purposes. Therefore, trustees applying for both an APRA and ASIC licence were (and still are) required to obtain an "APRA" police check from the Australian Federal Police and an "ASIC" police check from the same agency. There is an application fee for each police check as well as the costs of time and effort. Despite, industry raising concerns and some initial attempt by APRA to be flexible, we are not aware of any significant efforts within either regulator to take appropriate measures to ensure a single police check.

Another difference concerns notifying the regulator of any change in respect to the responsible officer. If an individual who was a responsible officer under both APRA and ASIC licensing left the licensee, then the licensee is required to inform both regulators separately. ASIC is to receive a completed FS 20 form and APRA to receive "Notification of change of composition of RSE licensee under the SIS Act" form. Neither regulator will accept the others form, so both forms, with similar but slightly different information, need to be completed and lodged separately. There are also slightly different timing requirements - the ASIC form is to be lodged within 10 business days of the change and APRA form within 14 days.

CONCLUSION

If you have any questions or comments on this submission, please feel free to contact me, Michaela Anderson, Ross Clare or Brad Pragnell at the ASFA Secretariat on 02 9264 9300.

Yours sincerely,

Philippa Smith, CEO

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